

1 UNITED STATES BANKRUPTCY COURT

2 SOUTHERN DISTRICT OF NEW YORK

3 Case No. 08-13555-scc

4 - - - - - x

5 In the Matter of:

6

7 LEHMAN BROTHERS HOLDINGS INC.,

8

9 Debtor.

10 - - - - - x

11

12 U.S. Bankruptcy Court

13 One Bowling Green

14 New York, NY 10004

15

16 February 28, 2017

17 10:01 AM

18

19

20

21 B E F O R E :

22 HON SHELLEY C. CHAPMAN

23 U.S. BANKRUPTCY JUDGE

24

25 ECRO: KAREN / RACHEL\

1 Hearing re: Trial on Lehman's Objection to Claims of QVT
2 (Doc # 17468 Debtors' One Hundred Fifty-Fifth Omnibus
3 Objection to Claims)

4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 A P P E A R A N C E S :

2

3 HOGAN LOVELLS US LLP

4 Attorneys for QVT FUND LP

5 875 Third Avenue

6 New York, NY 10022

7

8 BY: NICOLE E. SCHIAVO

9 WILLIAM M. REGAN

10 BEN LEWIS

11 JOHN D. BECK

12 DENNIS H. TRACEY, III

13 ROBIN E. KELLER

14 DARYL L. KLEIMEN

15

16

17

18

19

20

21

22

23

24

25

1 JONES DAY

2 Attorneys for the Debtor

3 250 Vesey Street

4 New York, NY 10281

5

6 BY: LAURI W. SAWYER

7 DAVID P. SULLIVAN

8 JAYANT W. TAMBE

9 RYAN J. ANDREOLI

10 JENNIFER L. DELMEDICO

11 REBEKAH BLAKE

12 SARAH EFRONSON

13

14 ALSO PRESENT TELEPHONICALLY:

15

16 CHARLES WITTMANN-TODD

17

18

19

20

21

22

23

24

25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

P R O C E E D I N G S

THE COURT: Good morning, Karen. Good morning.
How is everyone?

MAN: Fine. Thanks, Your Honor.

MR. TRACEY: Good morning.

THE COURT: Ready? Ready when you are.

MR. TRACEY: Ready? Okay.

THE COURT: Yes.

MR. TRACEY: Thank you, Your Honor.

MS. KELLER: Your Honor, good morning.

THE COURT: Good morning, Ms. Keller.

MS. KELLER: One very brief housekeeping matter?

THE COURT: Sure.

MS. KELLER: I think last week the Debtors emailed
to your chambers their amended witness list --

THE COURT: Yes.

MS. KELLER: -- and schedule of testimony. We'd
like to hand up a claimant's fifth amended testimony
schedule which --

THE COURT: I think I missed the fourth.

MS. KELLER: No, you missed the fourth?

THE COURT: I did miss the fourth. I think that
was a super-secret one that Mr. Tracy had that --

MR. TRACEY: I --

THE COURT: -- he never shared with me.

1 MS. KELLER: I think that's true, Your Honor.

2 THE COURT: Right?

3 MR. TRACEY: It was the trial bulletin.

4 THE COURT: Remember? It was superseded --

5 MR. TRACEY: It didn't fly.

6 THE COURT: -- before you could even send it to
7 me. So, okay whatever it is.

8 MS. KELLER: Well, I thought it was the sixth, but
9 I'm told it's the fifth.

10 MS. SAWYER: But, Your Honor --

11 MS. KELLER: Simply for the purpose --

12 THE COURT: Well, let Ms. Keller finished.

13 Okay. Go ahead.

14 MS. KELLER: -- of bridging so that you have today
15 and tomorrow's witness schedule that --

16 THE COURT: Okay.

17 MS. KELLER: -- we'll be presenting. Your Honor,
18 we recognize that the Debtors have proposed a full day for
19 each of their experts, and we're not seeking to curtail
20 that, we're simply proposing that as each witness finishes,
21 the next begins, if that's possible on a day. And if we do
22 it that way we may be able to stay within the time period
23 allocated --

24 THE COURT: Okay. I'm --

25 MS. KELLER: -- by Your Honor.

1 THE COURT: -- and so now I'm not following you.

2 MS. KELLER: Okay. May I hand --

3 THE COURT: Yes.

4 MS. KELLER: -- may I approach and hand this up to
5 you?

6 THE COURT: Sure. Do you have --

7 MS. SAWYER: Well, that's my concern --
8 that's my concern, Your Honor.

9 THE COURT: Okay. Do you have a --

10 MS. SAWYER: Is they're proposing a schedule for
11 our witnesses that they're handing to you.

12 But I do have a copy, I just received it --

13 THE COURT: Do you have a copy?

14 MS. SAWYER: -- a moment ago. Yes.

15 THE COURT: Okay. So let me get on the same page
16 as all of you. Okay.

17 MS. KELLER: So starting today, Your Honor, we
18 have Mr. McDougall.

19 THE COURT: Yes.

20 MS. KELLER: And then Mr. Niculescu.

21 THE COURT: Dr. Niculescu.

22 MS. KELLER: Dr. Niculescu.

23 THE COURT: Okay. And Dr. Niculescu will also be
24 tomorrow?

25 MS. KELLER: Correct.

1 THE COURT: Right? And tomorrow we're together
2 for a whole --

3 MS. KELLER: Did I get it right that Your Honor
4 must finish tomorrow at four?

5 THE COURT: That's today.

6 MS. SAWYER: That's today.

7 MS. KELLER: That's today. Okay.

8 THE COURT: With a caveat that -- I'm going to get
9 in trouble, watch this. The thing -- I have something at
10 four, another Lehman matter. It's possible that I could get
11 through that in half an hour or 45 minutes. So if we're at
12 the point in the day where there's something that we could
13 accomplish in an additional 45 minutes to an hour, I would
14 be happy to have you wait. I would be happy to ask the 4
15 o'clock people, how long do you think you need so that we
16 could continue, rather than send you away at 4 o'clock.

17 If you would rather go away at 4 of course, that's
18 fine, too. Okay? So --

19 MS. KELLER: That sounds fine. Why don't we see
20 where --

21 THE COURT: So we can --

22 MS. KELLER: -- we are.

23 THE COURT: -- see what happens.

24 MS. SAWYER: That's fine, Your Honor.

25 THE COURT: All right. So that's today. Tomorrow

1 I have no restrictions, right? I had no restrictions on my
2 time tomorrow whatsoever. Okay? So that --

3 MS. KELLER: Should we start at --

4 THE COURT: -- that means that --

5 MS. KELLER: -- 9:30, perhaps?

6 THE COURT: Okay. I can do that. So on your
7 schedule, we're going to amend Wednesday the 1st to be 9:30
8 to 5:30.

9 MS. KELLER: Yeah.

10 THE COURT: Okay?

11 MS. SAWYER: Yes.

12 MS. KELLER: And then we hope Mr. -- Professor
13 Niculescu -- Dr. Niculescu will be done on the first, but on
14 the chance that he rolls over, we show that in brackets on
15 Tuesday, March 2nd.

16 THE COURT: Okay. Thursday, March 2nd.

17 MS. KELLER: And -- Thursday, March 2nd.

18 THE COURT: Right.

19 MS. KELLER: And if he doesn't roll over, or just
20 has a little bit to do, then perhaps Mr. Bruce could start
21 that day.

22 THE COURT: Okay. So now we're at the point that
23 it's Lehman's case?

24 MS. KELLER: Switching to Lehman's, yes.

25 THE COURT: Okay. So go ahead, Ms. Sawyer.

1 MS. SAWYER: I mean we have no problems having our
2 witnesses be available to start earlier. This is not the
3 schedule we proposed, and Ms. Keller called me last week
4 suggesting that maybe we try to limit the examination of our
5 expert witnesses to be able to consolidate the schedule. I
6 mean I don't -- we don't have any fundamental problem with
7 if Mr. -- or Dr. Niculescu is finished, Mr. Bruce would
8 start, but some of our expert witnesses do have availability
9 issues, so I can't agree --

10 THE COURT: Sure.

11 MS. SAWYER: -- to the schedule as written.

12 THE COURT: Okay.

13 MS. SAWYER: And so, you know, I think it is
14 something we probably should have discussed before we -- it
15 was proposed on our behalf.

16 THE COURT: Okay. But there's -- I mean, all that
17 this does is reflect a way to get -- okay.

18 The morning of the 28th, which is on this
19 schedule, is not a day that I'm available.

20 MS. SAWYER: I didn't -- we -- I wasn't aware of
21 that. I mean, I wasn't aware that we had court on the
22 morning of the 28th.

23 THE COURT: The morning of March 28th.

24 MS. KELLER: Okay.

25 THE COURT: I have baby judges here all week that

1 week. So we haven't -- according to our books and records,
2 we haven't given you past the 23rd.

3 MS. SAWYER: That's my understanding, too, Your
4 Honor.

5 THE COURT: So what I have had open up, just in
6 the last 48 hours, though, is the afternoon of the 29th --

7 (The Court and clerk confer)

8 THE COURT: the 30th.

9 MS. SAWYER: The 30th?

10 MS. KELLER: The 30th.

11 THE COURT: Yes. I have the 30th beginning at
12 about 11:30.

13 MS. SAWYER: Okay.

14 MS. KELLER: Not the 29th, Your Honor?

15 (The Court and clerk confer)

16 THE COURT: We could probably do something about
17 the 29th. Right, but the 30th definitely starting at 11:30.

18 So the point is, I know you want to get done, I'm
19 sure you want to get done, I have increased availability.
20 They're entitled to put on their case the way they want to
21 put on their case, including whether or not, you know, we
22 start a witness with an hour in the day to go. So I
23 appreciate this, I'll add it to my list -- my stack of
24 schedules and we'll see what happens.

25 MS. SAWYER: We're certainly committed, Your

1 Honor, to be as --

2 THE COURT: Sure.

3 MS. SAWYER: -- efficient as possible.

4 THE COURT: Understood.

5 MS. SAWYER: And we'll just let you know as to
6 what makes sense, given our witnesses' limitations.

7 THE COURT: Okay.

8 MS. KELLER: There's just one other point, Your
9 Honor.

10 THE COURT: sure.

11 MS. KELLER: I advised Ms. Sawyer that Kelly Fang,
12 who was listed for the 20th of March, on the Debtor's
13 schedule, is away the last two weeks in March. She would be
14 available on the 16th or earlier.

15 MS. SAWYER: I think that's something we can
16 discuss offline. I don't think --

17 THE COURT: Sounds good.

18 MS. SAWYER: -- we need to discuss it at this
19 time.

20 THE COURT: Okay. Sounds good.

21 All right. So for today we know what we're doing,
22 and I think for tomorrow we know what we're doing. Okay.

23 MS. SAWYER: Thank you.

24 THE COURT: And before we get to Mr. McDougall,
25 are we going to -- do you have -- I don't know who I'm

1 talking to, but do you have an understanding with respect to
2 what you want to do on Daubert/voir dire of Dr. Niculescu?

3 MR. TAMBE: So, Your Honor, we'll probably do what
4 we did with Professor Pflederer --

5 THE COURT: Okay.

6 MR. TAMBE: -- which is a brief voir dire on scope
7 of opinions and qualifications.

8 THE COURT: Is that all right?

9 MR. TRACEY: That's fine.

10 THE COURT: Okay.

11 MR. TRACEY: That's fine, Your Honor.

12 THE COURT: Anything else, housekeeping?

13 All right, so.

14 MR. LEWIS: QVT calls Christopher McDougall.

15 (The Court and clerk confer)

16 THE COURT: Ready when you are.

17 MR. LEWIS: Thank you, Your Honor.

18 THE COURT: Would you please stand up, Mr.

19 McDougall --

20 MR. MCDOUGALL: Yes.

21 THE COURT: -- and raise your right hand. Do you
22 solemnly swear or affirm that all the testimony you're about
23 to give before the Court shall be the truth, the whole truth
24 and nothing but the truth?

25 MR. MCDOUGALL: Yes.

1 THE COURT: All right. Please have a seat and
2 make yourself comfortable. And let us know at any time if
3 you need a break.

4 MR. MCDOUGALL: Great.

5 DIRECT EXAMINATION OF CHRISTOPHER MCDOUGALL

6 BY MR. LEWIS:

7 Q Good morning, Mr. McDougall. Please, can you state
8 your full name for the record?

9 A Yes. Christopher McDougall.

10 Q And Mr. McDougall, do you recall your deposition on the
11 28th of July 2016?

12 A I recall that it happened, yes.

13 Q And have you and I spoken other than during your
14 deposition?

15 A No.

16 Q Have you spoken to anyone at Hogan Lovells other than
17 during your deposition?

18 A I have not.

19 Q Have you spoken to anyone at QVT other than during your
20 -- since your deposition?

21 A No.

22 Q Mr. McDougall, were you previously employed by Lehman
23 Brothers?

24 A Yes, I was.

25 Q And when did you begin working there?

1 A Approximately August of 2003.

2 Q And when did you leave Lehman Brothers?

3 A Well, I was employed at the date of the bankruptcy
4 filing, that's -- I continued to go to the office for a few
5 more months until things were resolved with severance and
6 such items.

7 Q And in which group or department at Lehman did you
8 work, immediately after you joined Lehman Brothers?

9 A At that time I was in the mortgage middle office group.

10 Q And what was your title at that time?

11 A I believe it was senior analyst.

12 Q And did you change groups or departments at any time
13 while you were employed by Lehman?

14 A Yes.

15 Q And when was that?

16 A Approximately August of '04.

17 Q And into which group did you move?

18 A I joined the structured finance trading desk.

19 Q And did you stay in the structured finance trading
20 group from 2004 until the time that you left Lehman?

21 A Yes.

22 Q And did your title change at any point during your time
23 with Lehman?

24 A Yes.

25 Q What did it change from and to, if you recall?

1 A I know that it changed to vice president.

2 Q And what did you do after you left Lehman?

3 A Can you be more specific?

4 Q Sure. Did you undertake any further studies after
5 leaving Lehman?

6 A Yes. I attended a master's program.

7 Q And by whom are you currently employed?

8 A A company called Eastern Generation.

9 Q And what line of business -- what line of business are
10 they in?

11 A Probably it's in the energy industry.

12 Q Thank you. Now Mr. McDougall, during your time at
13 Lehman Brothers, what categories of securities did you
14 trade?

15 A The book was generally known as the consumer ABS book,
16 asset backed securities book. So credit card loans -- or
17 securities backed by credit card debt, auto loans, student
18 loans primarily.

19 Q And during your time at Lehman Brothers did you ever
20 trade a product known as CARB?

21 A Yes.

22 Q And do you recall anyone else at Lehman trading CARB,
23 apart from yourself?

24 A Yes. I believe Mr. McNiff traded CARB as well.

25 Q Did you consider yourself to be Lehman's primary CARB

1 trader?

2 A During the period that I traded it, I would consider
3 myself the primary trader.

4 Q I'm taking you a step back. Please, could you describe
5 your understanding of the CARB product for the Court?

6 A CARB was a derivative product that referenced a series
7 of auto loan securitizations.

8 Q And when you say a reference to a series of auto loan
9 securitizations, did CARB reference any particular tranches
10 of those securitizations?

11 A The -- the securities that I recall trading or the CARB
12 product that I recall trading referenced the Triple B
13 tranches of those securitizations.

14 Q And do you recall how many auto ABS deals were
15 referenced by CARB?

16 A I believe it was eight.

17 Q And do you recall how it was determined, at CARB's
18 inception, which auto ABS deals would be referenced by CARB?

19 A I recall working -- I recall reviewing the
20 securitizations on the market at the time, and -- and
21 proposing the basket of eight securities that CARB should
22 reference.

23 Q And how would you describe the basket of eight
24 securities that CARB did reference?

25 A They were issued by GM and Ford, four and four, I

1 believe was the split.

2 Q And how did CARB reference those eight underlying
3 (indiscernible)?

4 A Can you be more specific?

5 Q Sure. Was the performance of CARB in any related to
6 the underlying -- the eight underlying auto ABS deals?

7 MS. EFRONSON: Objection. Leading.

8 THE COURT: Why don't you ask it a different way?

9 MR. LEWIS: Of course. Right.

10 Q Was there any relationship, in terms of performance,
11 between CARB and the securities that it referenced?

12 A Generally, yes.

13 Q How so?

14 A So in the -- on a day to day basis, you know to the
15 extent that it traded, CARB traded at a value at which it
16 traded kind of independent, but the sort of long term payout
17 of a CARB position would depend upon the performance of the
18 underlying securities.

19 Q Did you trade CARB as eight individual CDS or at one
20 package?

21 A As one package.

22 Q And were you involved in the development of the CARB
23 product?

24 A Yes.

25 Q Are you aware of any discussions with anyone at QVT, in

1 relation to CARB, while it was being developed?

2 A Yes.

3 Q And with whom were those discussions had?

4 A Arthur Chu.

5 Q Mr. McDougall, you should have in front of you a binder
6 of documents and there are tabs on the outside. If you
7 could turn, please to document that is CX-1127.

8 A Excuse me.

9 Q And if it helps, John will put up a soft copy of the
10 document on the screen as well. And do you recognize this
11 document?

12 A I don't specifically recall this -- this document, but
13 I see it.

14 Q Do you see that it was sent from an email address
15 cmdougall1@bloomberg.net?

16 A Yes.

17 Q Was that your Bloomberg address on January 16th, 2008?

18 A I believe so.

19 Q Do you have any reason to believe that you did not send
20 this message?

21 A No.

22 Q And do you see, looking at the attachments line, that
23 there are four attachments to this message?

24 A Yes.

25 Q If we could quickly look at those attachments one by

1 one. The first one runs from the second page and if it
2 looks at the bottom right-hand corner, there's a number. So
3 the first document runs from LEH-QVT_0008626 --

4 MS. SAWYER: Objection. Relevance.

5 THE COURT: Well, I don't -- it depends on what
6 the question is going to be. Is it objection to relevance
7 or something else?

8 MS. SAWYER: May I approach?

9 THE COURT: Okay. Come on up.

10 (Bench conference not recorded)

11 THE COURT: Okay. So the pending question was
12 asking you, Mr. McDougall, to look at the first attachment,
13 I believe, yes?

14 MR. MCDUGALL: Yes.

15 Q And Mr. McDougall, if it helps, that first attachment
16 runs from Page 8626 to 8648. And my question is simply what
17 do you recognize this document to me?

18 A I recognize it as what it says it is. I believe it
19 would generally be described as an ISDA document.

20 Q And looking at the second attachment, which runs from
21 8649 through to 8671, what do you recognize that document to
22 be?

23 A This -- looking at it briefly right now, it's -- is it
24 the same document? I believe it's the same document.

25 Q And then turning to the third attachment, which starts

1 at Page 8672 and runs to Page 8681.

2 A Yes.

3 Q What do you recognize that document to be?

4 A This is a piece of Lehman Brother's research from the
5 U.S. MBS/ABS strategy team.

6 Q And did this research piece relate to the CARB product?

7 A Yes. It's an introduction to CARB.

8 Q And then turning to the fourth and final attachment,
9 which begins at Page 8682 and runs to the last page, 8708.
10 Same question, what do you recognize that document to be?

11 MS. SAWYER: Objection. Foundation.

12 THE COURT: Yeah, we are at the point of there not
13 being any foundation for this. This is simply asking the
14 witness to identify documents and not even establishing that
15 he has any recollection from the date of the documents. So
16 I think before we go any further you need to lay the
17 foundation.

18 Q Okay. Mr. McDougall, you testified that the research
19 piece related to CARB; is that correct?

20 A Yes.

21 Q And does the slide deck beginning on Page 8682 also
22 relate to CARB?

23 THE COURT: It's not a question of whether or not
24 these documents relate to CARB.

25 Q Mr. McDougall, were these marketing materials sent to

1 your clients in relation to CARB?

2 THE COURT: Mr. McDougall, let me interject. It's
3 2017, this is a document dated 2008. If you remember
4 specifically, please tell us. If you don't remember, you're
5 obligated to tell us that as well. It's perfectly -- it's
6 an everyday occurrence that people cannot recollect things
7 that happened that long ago, so the questions are simply
8 designed to ask you for your best recollection as you sit
9 here today. Don't assume, don't speculate, simply give us
10 your best recollection. All right?

11 MR. MCDOUGALL: Yes. Thank you.

12 THE COURT: All right.

13 MR. MCDOUGALL: The one thing I checked -- well
14 the undisclosed recipients, so I don't.

15 Q Mr. McDougall, if I could show you a document which
16 might help refresh our recollection on this. Could you turn
17 to exhibit DX-5040 in your book?

18 A 5040?

19 Q Yes, please. And looking at the lower message in that
20 chain, from yourself, and if you could look at the portion
21 of the message that has two asterisks next to it. Does this
22 refresh your recollection as to whether the research piece
23 and presentation slides were distributed to Lehman's
24 clients?

25 MS. SAWYER: Objection. Foundation.

1 MR. MCDOUGALL: Not necessarily.

2 THE COURT: Hold on.

3 (Bench conference not recorded)

4 Q Mr. McDougall, turning back to Exhibit 1127, do you
5 have a recollection today as to whether you distributed the
6 research piece and the slide deck to Lehman's clients in the
7 2007 to 2008 time period?

8 A I don't recall specifically who that email went to.

9 Q But do you have a recollection, at all, as to whether
10 those two documents were sent to Lehman's clients, at that
11 point in time?

12 A Sorry, could you repeat the question?

13 Q Your answer was that you didn't recall specifically who
14 that email went to, and the separate question was whether
15 you had a recollection as to whether those documents were
16 sent to Lehman's clients in the time period between 2007 and
17 Lehman's filing.

18 A I don't recall.

19 Q And turning back to the first page of Exhibit 1127, in
20 your email you say that Markit will, "handle the marketing
21 of CARB." What did you mean by that?

22 MS. SAWYER: Objection. Foundation.

23 THE COURT: Well, those are his words, so he --
24 you can answer, Mr. McDougall.

25 MR. MCDOUGALL: So I believe --

1 THE COURT: Let me clarify. You can answer as to
2 your understanding.

3 MR. MCDOUGALL: Um hmm.

4 THE COURT: But to the extent that the question
5 asks for you to give a view about what -- independently
6 about what Markit might have been doing, that's outside the
7 scope of the question.

8 MR. MCDOUGALL: Okay. I believe it was
9 referencing the fact that we were having conversations with
10 Markit to have them -- it says "marketing of CARB to the
11 rest of the dealer community," so to increase the number of
12 banks that traded CARB.

13 Q And you say that that would create better liquidity.
14 What did you mean by that?

15 A The thought at the time was more dealers trading a
16 product and Markit administrating the product could lead to
17 better liquidity in the product.

18 Q Okay. And in Paragraph 2 you say that, "We believe
19 from this point CARB could be up and running, as part of the
20 Markit indexes, relatively soon." What did you mean by
21 that?

22 A I was putting forth the idea that something would work
23 out with Markit, in terms of having them market and
24 administrate this product and we would move forward
25 relatively soon. I don't know what kind of time horizon I

1 was referring to.

2 Q And do you know whether CARB was ultimately included in
3 those Markit indices?

4 A It was not.

5 Q And what was your understanding as to why CARB was not
6 included in the Markit indices?

7 A As far as I recall today, the dealer community was not
8 as interested in trading the product as we maybe initially
9 thought.

10 Q And Mr. McDougall, if you turn to the back of Exhibit
11 CX-1127, and three pages from the back, on Page 8706 there's
12 a list of contacts at Lehman Brothers. Is that what you
13 understand Page 8706 to reflect?

14 A That page was contact information, yes.

15 Q And is that your contact information listed as at that
16 point in time?

17 A Yes.

18 Q And do you know to whom this contact information was
19 provided, in the 2007, 2008 period?

20 A It was provided to many people.

21 Q Please, could you summarize the categories of people
22 outside Lehman to whom this contact if was provided, in
23 relation to the CARB product in that time period?

24 A Clients.

25 Q And did Lehman's clients contact you, in that time

1 period, in relation to the CARB product?

2 A Yes.

3 Q And did you have communications, during that time
4 period, with Lehman's clients, in relation to the CARB
5 product?

6 A Some of them, yes.

7 Q Did you have communications with anyone at QVT during
8 that time period related to the CARB product?

9 A I believe so. I'm just pausing on the time period that
10 we're thinking about. Is this in the same time period as
11 the email, I guess?

12 Q The time period I had in mind was from the inception of
13 CARB to Lehman's filing.

14 A Okay.

15 Q What would that time period represent to you?

16 A So this is the time period of CARB's existence and
17 Lehman Brother's operating as an ongoing concern? Yeah, so
18 late 2007 through September of 2008.

19 Q And did CARB trade after Lehman filed for bankruptcy,
20 as far as you know?

21 MS. EFRONSON: Objection.

22 THE COURT: I'm sorry, I was looking at an
23 exhibit, and I missed the question --

24 MR. LEWIS: I can rephrase --

25 THE COURT: -- and the objection.

1 MR. LEWIS: -- if that's --

2 THE COURT: Okay. Go ahead.

3 Q To your knowledge, did CARB trade after Lehman's filing
4 in 2008?

5 A Not that I know of.

6 Q So within the time period from CARB's inception in late
7 2007 to Lehman's collapse in September 2008, did you
8 communicate with anyone at QVT in relation to the CARB
9 product?

10 A Yes.

11 Q And who was that?

12 A Arthur Chu.

13 Q And do you recall whether you provided any written
14 materials to Mr. Chu in relation to the CARB product?

15 A I don't recall.

16 Q And Mr. McDougall, could you please turn to Exhibit
17 2162?

18 A Sorry, what was the --

19 Q Oh, sorry. 2162.

20 A What were the first letters?

21 Q CX.

22 A 2162? Okay.

23 Q Thank you. And at the top there's an email from Mr.
24 Charles Spero at Lehman, to Mr. Chu, copying yourself. Who
25 is Mr. Spero, at this point in time?

1 A I don't know his specific title, but he was a senior
2 member of the trading desk I worked on, the structured
3 finance trading group.

4 Q And if you look at the earliest message in this chain,
5 from a Mr. David De Luca, to Arthur Chu, copying Ian
6 Kennedy, do you see that at the bottom of that message there
7 are two attachments, CARB Index Prima Final and CARB
8 Presentation -- CARB Prima Presentation.pdf. Who was
9 Mr. De Luca -- what role did Mr. De Luca fulfill at Lehman
10 at this point in time, if you know?

11 A I don't know.

12 Q And do you know what those documents, CARB Index Prima
13 Final.pdf and CARB Prima Presentation.pdf, do you know what
14 those documents were?

15 MS. EFRONSON: Objection, Your Honor. We don't
16 have the attachments here.

17 MS. SAWYER: And it's not his email.

18 MS. EFRONSON: And it's not his email.

19 THE COURT REPORTER: I can't hear you.

20 MS. EFRONSON: Objection. The attachments are
21 missing, and it's also not Mr. McDougall's email.

22 THE COURT: Do we have the attachments?

23 MR. LEWIS: Your Honor, if we turn -- if you --
24 Mr. -- if everyone could keep one finger in this exhibit and
25 then turn to Exhibit 2158. You'll see it's CX-2158.

1 MS. SAWYER: Objection, Your Honor.

2 THE COURT: Yes?

3 MS. SAWYER: This document doesn't have Mr.
4 McDougall.

5 THE COURT: Okay. Karen tells me to speak up. So
6 take that microphone away from Mr. Tambe and pull it --
7 okay.

8 So we are -- you have us in 2162. Now we're in
9 2158 --

10 MR. LEWIS: Yes --

11 THE COURT: -- which has the attachments?

12 MR. LEWIS: So I think, Your Honor, it's the same
13 email chain?

14 THE COURT: Yes.

15 MR. LEWIS: 2162 is a reply which copies Mr.
16 McDougall. 2158 is Mr. Chu's email, which includes the
17 attachments.

18 (Counsel confer)

19 MS. SAWYER: Your Honor, this calls for
20 speculation, because we just don't know if they're the same
21 attachments.

22 THE COURT: Could you come up again, please?

23 (Bench conference not recorded)

24 THE COURT: Here you go.

25 MAN: May I approach, Your Honor?

1 THE COURT: Sure. I'm giving you my best Post-
2 its.

3 MAN: I appreciate it. I will return it. Excuse
4 me.

5 Q Mr. McDougall, while you were at Lehman, apart from
6 CARB, did you trade any other auto loan backed derivative
7 products?

8 A Not that I recall.

9 Q And while at Lehman, were you aware of anyone else at
10 Lehman who trade day other auto loan backed derivative
11 products?

12 A Not that I call.

13 Q Did you ever trade, while at Lehman, the individual
14 component CDS of CARB?

15 A Not that I recall.

16 Q And are you aware of anyone else at Lehman who traded
17 the individual component CDS of CARB?

18 A I am not.

19 Q Did Lehman make two way markets in CARB?

20 A Yes.

21 Q And are you aware of any other dealers who were making
22 two way markets in CARB, at any point in time?

23 A I am not aware of that.

24 Q And are you aware of anyone, apart from Lehman or
25 Lehman's counterparties, who traded CARB?

1 A I am not.

2 Q Did you ever trade CARB with any other dealer?

3 A Not that I recall.

4 Q And are you aware of anyone making a two way market on
5 the component CDS of CARB?

6 A I am not aware of that.

7 Q While at Lehman, did you send out CARB runs offering to
8 sell or buy protection in CARB?

9 A Yes.

10 Q And did those runs include the prices at which Lehman
11 was willing to transact in CARB?

12 A Yes.

13 Q Did you send any CARB runs to QVT?

14 A It's possible.

15 THE COURT: Could we have a time frame on the
16 question, please?

17 MR. LEWIS: Sorry. Yeah.

18 Q Between CARB's inception in late 2007 and the 15th of
19 September, 2008 did you send any CARB runs to QVT?

20 A It's possible.

21 Q Were you determined -- were you responsible for
22 determining the bid offer spread used in CARB?

23 A During the time frame that I was trader, yes.

24 Q And how did you calculate the bid offer spread used in
25 CARB runs?

1 A It wasn't so much of a calculation as a sort of market
2 based judgment.

3 Q And what factors went into that judgment call?

4 A Excuse me. The -- sorry, repeat the question.

5 Q Sure. That -- if -- there's a bottle of water there if
6 you want. What factors went into that judgment call?

7 A The things we considered in making markets on CARB, as
8 far as I recall, included conditions -- market conditions in
9 the ABS market, market conditions in the sort of broader
10 credit markets, and then kind of our positioning in the
11 product, and kind of relevant data points.

12 Q And, when you speak about your -- Lehman's positioning
13 in the product, did you consider whether, on an aggregate
14 basis, Lehman was net long or net short CARB in determining
15 prices in the bid offer spreads?

16 A Generally, that would be something I would have in
17 mind.

18 Q And, as far as you recall, did you ever use Intex to
19 price CARB?

20 A Not that I recall.

21 Q What was the typical size of each CARB transaction?

22 A I don't recall.

23 Q And, in setting the price levels in the bid/ask
24 spreads, in the CARB runs, did you ever use a model to
25 arrive at those numbers?

1 A Sorry, can you repeat the question?

2 Q Sure. Did you ever use a model to arrive at the price
3 levels of bid/ask spreads used in the CARB runs?

4 A A model would be used to translate a given spread to a
5 price that we would then quote. But there was more of an
6 input than sort of a driver of the market that we would
7 quote.

8 Q And, when you talk about a model translating spread to
9 price, would that be the CDSW screen in Bloomberg?

10 MS. EFRONSON: Objection, leading.

11 MR. LEWIS: I can rephrase, sorry.

12 THE COURT: Okay.

13 Q When you testified about a model used to translate
14 spread to price, what model were you referring to?

15 A I believe my colleague, John Lee, maintained a model
16 that would help calculate that.

17 Q And was anyone beside yourself responsible for
18 calculating the bid and offer levels on the two-way CARB
19 markets that Lehman was publishing?

20 MS. EFRONSON: Objection, calls for speculation.

21 THE COURT: Could you repeat the question?

22 MR. LEWIS: Was anyone apart from yourself responsible for
23 calculating the bid/offer levels on the two-way CARB markets
24 that Lehman was publishing?

25 THE COURT: If you know, you can answer.

1 MR. MCDUGALL: During the time that I was the trader on
2 CARB, I would determine the bid and offer.

3 Q And during which time period were you the trader on
4 CARB?

5 A I believe the time period was late 2007 to early 2008.

6 Q Mr. McDougall, please can you turn to Exhibit CX1132?
7 Do you recognize this message exchange?

8 A I don't recall it specifically, but I see it.

9 Q And who is Mr. -- what role did Mr. McNiff perform at
10 Lehman at this point in time?

11 A Not sure of his title, but he was another senior member
12 of the trading team, I know more senior than I.

13 Q And, if you look at the lower message, it's -- it
14 appears to be from yourself, on the 5th of February, 2008.
15 What do you recognize that document to be?

16 A Can you be more specific?

17 Q Do you see the message -- the lowest message on the
18 page?

19 A Yes.

20 Q At 8:36?

21 A Yes.

22 Q Oh. What do you understand that message to be
23 conveying to its recipient?

24 A Yes. That looks like a run, as we've been calling it,
25 an indication of bid and offer prices for CARB tranches.

1 Q And, if you look at the line that starts, "CARB 07-
2 1BBB," at what price was Lehman offering to buy and to sell
3 CARB as of this date?

4 A Per this document, Lehman would buy at 84 and sell at
5 86.

6 Q And do you have any reason to believe that you didn't
7 send this document on the 5th of February?

8 A I do not.

9 Q And below that, there are -- there's a reference to
10 CARB 07-1AAA and CARB 07-1A. Did you ever trade those CARB
11 securities?

12 A I don't believe so.

13 Q To your knowledge, were those tranches of CARB ever
14 traded?

15 A I don't believe so.

16 Q Which tranches of CARB do you understand to have been
17 traded?

18 A I know I traded the BBB.

19 Q And then Mr. McNiff responds, and he says, "Do you look
20 at where GM and FMCC CDS is trading when you quote this?"
21 What did you understand him to be asking you?

22 A Recalling from where I sit today, he's asking me if I
23 look at GM and Ford, the issuers on the securities within
24 CARB, if where their corporate parents are trading in the
25 corporate credit markets.

1 Q And, if you look at your response, which is the top
2 message, what did you mean by, "Yeah, was bidding at wide
3 FMCC at one point"?

4 A I believe, on a spread basis, I'm saying the bid, the
5 spread that corresponded to what in this example is 84, was
6 greater than where FMCC was trading in the corporate credit
7 markets.

8 Q And then you go on to say, "Arthur started covering
9 then and brought it back up." What did you mean by that?

10 A To the best that I recall, I believe I'm saying Arthur
11 at QVT was covering, meaning taking the opposite direction
12 of their original position, and that caused the market for
13 CARB to go higher.

14 Q So, did you understand Arthur's trading, or Mr. Chu's
15 trading, to have moved the CARB market?

16 MS. EFRONSON: Objection, leading.

17 THE COURT: Sustained.

18 Q Did you have an understanding at this point --

19 THE COURT: Could we -- could you ask the witness about the
20 last sentence in the top email, please?

21 MR. LEWIS: Oh, sure.

22 Q Mr. McDougall, you say from there, "Have just moved it
23 with auto CDS moves that have been through." What did you
24 mean by that?

25 A I believe I'm saying... the auto CDS reference is

1 another way of speaking about the GM and FMCC spreads. So,
2 just under -- you know, underscoring the idea that I'm
3 following what GM and FMCC are doing, kind of directionally.

4 Q And, when you said, "Arthur started covering then and
5 brought it back up," did you have an understanding as to
6 whether Mr. Chu's trades had an effect on the CARB market?

7 MS. EFRONSON: Objection, leading.

8 THE COURT: Could we limit the question to what he meant by
9 the words on the page?

10 Q When you say "brought it back up," what did you mean by
11 that?

12 A I believe I'm referencing the price of CARB BBB.

13 Q And what had caused the price of CARB BBB to be brought
14 back up?

15 A Based on this email, I'm saying Arthur's covering.

16 Q Thank you, Mr. McDougall. If you could turn, please,
17 to Exhibit --

18 THE COURT: I'm sorry. Before you leave this page, could
19 you -- Mr. McDougall, could you just explain what the words
20 at the very end of the top block, "but have been through,"
21 means?

22 MR. MCDUGALL: So, I believe what I'm saying is that,
23 whereas, initially in this statement, I was saying wide to
24 FMCC CDS, now I'm saying we're through, so tighter than
25 where that was previously. So, through is kind of a way of

1 saying tighter in the -- on a -- when thinking about these
2 products on a spread basis.

3 THE COURT: Okay. Thank you.

4 Q Mr. McDougall, one last question on this one. When you
5 refer to FMCC in your -- in the top line of your top email,
6 is it your understanding that you were referring to Ford,
7 the carmaker, or to a different Ford entity?

8 MS. EFRONSON: Objection, leading.

9 MR. LEWIS: I can rephrase it.

10 THE COURT: Okay.

11 Q When you refer to FMCC, which Ford entity were you
12 referring to?

13 A I think that reference is specifically the Ford Motor
14 Credit Corp, if I recall correctly, so their financing arm.

15 Q And what's your understanding of any difference between
16 Ford and FMCC in terms of the type of business they do?

17 A I believe one arm is the manufacturer and one arm --
18 the credit corporation is the consumer finance portion of
19 the business.

20 Q Mr. McDougall, if you could please turn to Exhibit
21 CX1132? Oh, sorry, 1131, one page -- one prior. And the
22 bottom email here is a message from Jaime Aldama to yourself
23 and Mr. Spero, 5th of February, 2008. Mr. Aldama's email
24 states that Markit is in talks with a consortium of dealers
25 to launch an index linked to auto ABS securities. And Mr.

1 Spero responds, copying yourself, and says that he assumes
2 they're speaking of CARB. Did you have the same
3 understanding at this point in time?

4 MS. EFRONSON: Objection, calls for speculation.

5 THE COURT: If you recall, you can answer, Mr. McDougall.

6 MR. MCDUGALL: It seems reasonable that I would think that
7 as well.

8 Q And the text of Mr. Aldama's email states that, quote,
9 "The specter of rising delinquencies on auto loans has many
10 looking for ways to hedge against their exposure in that
11 sector of the ABS market," and then goes on to say that
12 investors were interested in, quote, "shorting the auto
13 sector of the ABS market, particularly the subordinate
14 tranches." Is that consistent with your understanding at
15 this point in time?

16 MS. EFRONSON: Objection, mischaracterizing the document.

17 THE COURT: Would you refocus us on the section that you're
18 looking at, please?

19 Q So, Mr. McDougall, if you look at Mr. Aldama's email on
20 Exhibit CX1131, and the bottom half of that email, there's a
21 sentence that begins, "The specter of rising delinquencies
22 on auto loans has many looking for ways to hedge against
23 their exposure in that sector of the ABS market." And then
24 it goes on to say that investors were -- or certain
25 investors were interested in shorting the auto sector of the

1 ABS market, particularly the subordinate tranches. And the
2 question was whether that was -- that description was
3 consistent with your understanding at the time.

4 A I don't know.

5 Q Fair enough. And there's a reference here to the
6 subordinate tranches of auto ABS. Did CARB BBB reference
7 subordinate tranches of auto ABS?

8 A Yes.

9 Q And, Mr. McDougall, if you could please turn to Exhibit
10 1144? And what do you recognize this exhibit to be?

11 A This appears to be a Bloomberg exchange or email.

12 Q And who is --

13 A An exchange between myself and Xavier Goss.

14 Q And who is Xavier Goss?

15 A As far as I recall, he was an ABS -- he was a client at
16 Blackrock.

17 Q And you say, "Working with Markit is dead at this
18 point. Will continue to quote CARB to provide liquidity to
19 guys that have been involved, but it barely trades at this
20 point." What did you mean by that?

21 A So, it appears the Markit initiative discussed earlier
22 is not going anywhere. And this is me saying we'll continue
23 to make -- to quote markets in the product, but that, you
24 know, trading activity is low at this point.

25 Q And when you say "it barely trades," were you referring

1 to CARB?

2 A I believe so, yes.

3 Q And then you reply to Mr. Goss, "The dealers that came
4 to us originally faded." What did you mean by that?

5 A I believe I'm saying the indications that we had sort
6 of based our thinking on to go to market with had changed.

7 Q And, Mr. McDougall, if you don't mind turning to the
8 next one, which is CX1145? What do you recognize this
9 exhibit to be?

10 A So, at the top, it's me forwarding a message to -- or
11 looks like an internal group, and the below message is a
12 message from Markit.

13 Q And, in that below message from Markit, it states,
14 quote, "Markit has received an indication from the broad
15 dealer group that there is insufficient interest in moving
16 forward with the development of this index." Did you
17 understand that statement to relate to the CARB product?

18 A I think he's referencing a product called ABX.Auto,
19 which I believe was -- in the conversations we were having,
20 was analogous to CARB.

21 Q And Mr. Logan says that there was insufficient interest
22 in moving forward. Was that consistent with your
23 understanding at the time?

24 A I believe so.

25 Q And Mr. Logan goes on to say, if and when there is a

1 renewed desire to bring the product to market, we look
2 forward to working with you. Are you aware of any renewed
3 desire to bring the CARB product to market?

4 A I don't know.

5 Q So, Mr. McDougall, if you look at the period between
6 the 1st of August, 2008, and the 15th of September, 2008,
7 apart from Lehman, are you aware of any other dealer trading
8 CARB during that period?

9 A Not that I'm aware of.

10 Q And do you recall Lehman entering any trades in CARB in
11 September 2008?

12 MS. EFRONSON: Objection, foundation.

13 THE COURT: You can answer, if you know, to the extent that
14 you know.

15 MR. MCDUGALL: Sorry, can you repeat the question?

16 Q Do you recall Lehman entering any trades in CARB in
17 September of 2008?

18 A I don't recall.

19 Q And do you recall how many CARB counterparties had open
20 positions with Lehman at the time Lehman filed for
21 bankruptcy?

22 A I don't know.

23 Q If you could, please turn to Exhibit CX1263. There's a
24 hard copy of the email in your binder, and then John will
25 put a copy of the attachment up on your screen. The email

1 is from a Mr. James Whitticom. That's -- Linda, that's W-H-
2 I-T-T-I-C-O-M. And what role did Mr. Whitticom fulfill at
3 Lehman at this point in time?

4 A He was another member of the structured finance trading
5 team.

6 Q And, if you look at the Excel document --

7 THE COURT: Hold on one second. Yes?

8 MS. EFRONSON: Objection, foundation, Your Honor.

9 THE COURT: Are you going to get there?

10 MR. LEWIS: I'm just going to ask if this refreshes his
11 recollection as to the open positions.

12 MS. EFRONSON: We would ask that the spreadsheet gets
13 removed until there's foundation.

14 Q I think you testified that Mr. Whitticom had a role in
15 the ABS team at Lehman; is that correct?

16 A He was another member of the team, yes.

17 Q And do you have an understanding of what Mr. Whitticom
18 was sending to himself on the Sunday the 14th of September,
19 2008?

20 MR. LEWIS: Let me retract that one.

21 THE COURT: Good idea.

22 MR. LEWIS: Thank you. Thank you.

23 Q Did Mr. Whitticom have any involvement with the CARB
24 products, to your knowledge?

25 A Can you be more specific?

1 Q What is your understanding as to Mr. Whitticom's
2 involvement, if any, in the -- in relation to the CARB
3 product?

4 A I don't recall.

5 Q Did -- are you aware of whether Mr. Whitticom had any
6 role in recording Lehman's trades in the CARB product?

7 MS. EFRONSON: Objection, calls for speculation.

8 THE COURT: If he knows. If you know.

9 MR. MCDOUGALL: I don't recall specifically Mr. Whitticom's
10 responsibilities.

11 MR. MCDOUGALL: Your Honor, may we approach quickly?

12 THE COURT: Okay. None of this is a reflection on you.

13 But, secondly, we're going to take a break now, since you've
14 been up there for an hour. So, we'll come back in 10
15 minutes, by which time we'll have resolved this issue. You
16 remain under oath during the break. Please do not discuss
17 your testimony or the case with anyone or be in anyone's
18 presence while they're doing the same. All right? We'll
19 resume at 11:15 as a group. Do you want to do this here or
20 do you want to step into the conference room?

21 MR. MCDOUGALL: Whatever Your Honor prefers.

22 THE COURT: Why don't we step in the conference room so I
23 can look at what you're trying to show me?

24 CLERK: Recess.

25 (Recess)

1 THE COURT: All right? Everyone ready? Okay.

2 Q Mr. McDougall, you testified previously about the time
3 period in which you traded CARB. What was that time period?

4 A From what I recall, it was -- I believe I said late
5 '07, early '08.

6 Q And did anyone take over your responsibilities for
7 trading CARB?

8 A I believe Mr. McNiff took on the trading of CARB.

9 Q And do you recall when he took on those
10 responsibilities?

11 A Not specifically, no.

12 Q Mr. McDougall, could you please turn to an exhibit --
13 it's at the front of your book; it's Exhibit JX39?

14 A Okay.

15 Q And, if you turn to Page 60523? And, if your eyesight
16 is very good, nine lines up from the bottom, do you see your
17 name and email address there?

18 A I do.

19 Q And then, turning to the last page of the exhibit,
20 60525, and looking at the subject line, what do you
21 understand that subject line to represent?

22 MS. EFRONSON: Objection.

23 THE COURT: Yes?

24 MS. EFRONSON: Foundation.

25 THE COURT: Did you receive this email, Mr. McDougall?

1 MR. MCDUGALL: I believe so, based on my email being in the
2 recipient list.

3 THE COURT: Okay. All right. You -- can you ask the
4 question again, please?

5 MR. LEWIS: Sure.

6 Q Mr. McDougall, do you have any reason to believe you
7 did not receive this email?

8 A I do not.

9 Q And what do you understand the subject line of this
10 email to represent?

11 A This is a market on the CARB BBB.

12 Q And, as at this date, August 21st, 2008, at what price
13 was Lehman offering to buy and to sell CARB?

14 A Lehman would buy at 77 and sell at 81.

15 Q And are you aware of any CARB BBB runs sent out by
16 Lehman after 21st of August, 2008?

17 A Not that I'm aware of.

18 Q Mr. McDougall, did traders at Lehman have any
19 responsibility for marking their own books?

20 A I believe generally that was a responsibility of a
21 trader, for the products they traded.

22 Q And how often were traders supposed to do that?

23 A I remember it being a daily process.

24 Q And did that responsibility also extend to the CARB
25 trades?

1 A I don't see why CARB would be different.

2 Q And do you specifically recall marking your book in
3 relation to CARB positions during the period that you were
4 trading CARB?

5 A I do not.

6 Q And do you specifically recall changing Lehman's daily
7 CARB marks in relation to the prices at which Lehman was
8 quoting CARB in its runs at that time?

9 MS. EFRONSON: Objection, leading.

10 THE COURT: You can answer the question.

11 MR. MCDUGALL: Can you repeat the question?

12 MR. LEWIS: Sure.

13 Q Do you specifically recall changing Lehman's daily CARB
14 marks, consistent with the prices at which Lehman was
15 quoting CARB in its runs at that time?

16 A I don't recall.

17 Q And do you specifically recall changing Lehman's daily
18 CARB marks consistent with the prices at which Lehman
19 actually traded CARB?

20 A I don't recall.

21 Q And, during the period that you traded CARB, was QVT
22 one of your largest customers for CARB?

23 A From what I recall, yes.

24 Q And, Mr. McDougall, if we could just quickly run
25 through a few documents? If you turn to Exhibit 2152,

1 CX2152? It's a message you sent on 24th of January, 2008.

2 What do you recognize this document to be?

3 A This appears to be a Bloomberg update related to
4 products I was trading at the time.

5 Q And, Mr. McDougall, could you turn to Exhibit CX2154?
6 What do you recognize this document to be?

7 A This is a Bloomberg message indicating there would be
8 some auto-related bonds to trade, or kind of up for bid,
9 later that day or at some other time.

10 Q And, if you turn to the next one, 2155, what do you
11 recognize that document to be?

12 A This looks like a Bloomberg message also that I sent,
13 offering a caret GM auto loan bond.

14 Q And, at 2156, what do you recognize that document to
15 be?

16 A Another Bloomberg update. I'm posting that -- I
17 believe it's -- I believe I was trading the DD Ford bond
18 that is referenced below.

19 Q And then just two more, Mr. McDougall. At Exhibit
20 2160, what do you recognize that exhibit to be?

21 A Bloomberg message with some color, or notes on auto
22 loan bonds that were up for bid at a previous time.

23 Q And then, turning to Exhibit CX2161, what do you
24 recognize that document to be?

25 A Yeah, again, color from bonds that were -- it looks

1 like trading elsewhere that were in for bid.

2 MR. LEWIS: Your Honor, if I may have a moment, I may be
3 done.

4 THE COURT: Of course.

5 MR. LEWIS: Your Honor, no further questions.

6 THE COURT: Very good. Thank you.

7 MS. EFRONSON: Your Honor, may I just have a few moments?

8 THE COURT: Of course.

9 MS. EFRONSON: Thank you.

10 THE COURT: All right?

11 MS. EFRONSON: Yes.

12 THE COURT: Cross-examination, very good.

13 CROSS-EXAMINATION OF CHRISTOPHER MCDUGALL

14 BY MS. EFRONSON:

15 Q Good afternoon, Mr. McDougall. Sarah Efronson on
16 behalf of Lehman. I just have a few questions for you.

17 A Okay.

18 Q If you could turn to the document in the binder that
19 Mr. Lewis gave you, CX2155?

20 A Okay.

21 Q Okay? And, in the second line of the communication, it
22 says, "6MM Caret 07-1C." Do you see that?

23 A Yes.

24 Q Okay. And what is that?

25 A That is -- so, the 6 plus MM is \$6 million of principal

1 balance. And then Caret 07-1C is a particular auto ABS
2 bond.

3 Q Okay. And is that one of the components of CARB?

4 A I believe so.

5 Q And then, looking further at that same line, it says,
6 "12 Percent YLD at 14CPR - 4 Percent CDR - 100 Percent
7 Severity." Do you see that?

8 A I do.

9 Q Okay. And those are inputs into Intex for bond
10 modeling, right?

11 A They could be used for that, yes.

12 Q And, if you go down further into the communication, it
13 says, one line down, Asterisk, "This scenario implies 5
14 percent lifetime CUM losses and bond doesn't break." Do you
15 see that?

16 A Yes.

17 Q And what does it mean that the bond doesn't break?

18 A I believe, from what I recall, that's the bond does not
19 take losses. You wouldn't expect to receive less than your
20 full principal back.

21 Q And, if you can turn to CX2160 in the same binder,
22 please?

23 A 21-6-0?

24 Q Yes. And, looking down about five lines into the
25 communication, it says, "Caret 07-1C." And is that also a

1 component of CARB?

2 A It's the same bond as the previous email, so yes.

3 Q Okay. And, again, it says, following that, "9.5
4 percent YLD - 15 CPR 5 CPR - 75 percent." What is that?

5 A I believe that's the yield that that price equates to
6 under the assumptions around CPR loss severity, et cetera.

7 Q And you stated before that those are inputs that you
8 can put into Intex for bond modeling, right?

9 A Yeah, they would be assumptions to run through a model.

10 Q And those assumptions could be run on Intex?

11 A I believe so, yes.

12 Q And, again, looking about two lines down from where we
13 are, it says, "This scenario puts losses at 5 percent, two
14 times historical worst-case and bonds don't break." And
15 what is "bonds don't break"? What does that mean?

16 A Again, as they wouldn't -- they'd pay full principal
17 back. You wouldn't lose any principal.

18 Q And, in the last line of this communication, it says,
19 "Del-Qs are down, consistent with historical seasonality."
20 Do you see that?

21 A Yes.

22 Q And what does that mean?

23 A I think Del-Qs references delinquencies.

24 THE COURT: Ms. Efronson, for the completeness of the
25 record, could you back up a couple of words before "Del-Qs"?

1 MS. EFRONSON: Absolutely.

2 Q So, looking at the line above that, it says, "Our early
3 read on Jan performance from Apart and DCAT is that 30-60
4 Del-Qs are down, consistent w/ historical seasonality." And
5 my question is: what does "consistent with historical
6 seasonality" mean?

7 A I guess I'm trying to compare what we're seeing in the
8 January numbers and how that looks similar to what we've
9 seen in prior Januarys, or winters.

10 Q And can you explain what historical seasonality is?

11 A From what I recall, based on what I'm seeing here, I
12 think we had an expectation of -- or history was a reference
13 point for the performance of these underlying loans, kind of
14 over time.

15 MS. EFRONSON: Your Honor, may I have a moment?

16 THE COURT: Sure.

17 MS. EFRONSON: No further questions. Thank you, Mr.
18 McDougall.

19 THE COURT: All right. Anything more?

20 MR. TRACEY: Nothing from us, thank you.

21 THE COURT: You're good? Thank you very much, Mr.
22 McDougall. You can step down.

23 MR. TRACEY: Just take a moment to get ordered, Your Honor?

24 THE COURT: Yes, take as long as you need.

25 MR. TRACEY: You can sit right there.

1 MR. NICULESCU: (indiscernible)?

2 MR. TRACEY: Yeah.

3 THE COURT: Yeah, (indiscernible).

4 Dennis, do you have another one of these I could have?

5 MR. TRACEY: (indiscernible)

6 THE COURT: Do you have one more of these?

7 MR. TRACEY: I think we're straightened out here, Your

8 Honor. QVT --

9 THE COURT: Do you need more time?

10 MAN: No, we're fine.

11 THE COURT: Okay.

12 MR. TRACEY: QVT calls Dr. Peter Niculescu.

13 THE COURT: Very good. Good morning, Dr. Niculescu. Would

14 you please stand up, sir? Raise your right hand. Do you

15 solemnly swear or affirm that all the testimony you're about

16 to give before the Court shall be the truth, the whole

17 truth, and nothing but the truth?

18 MR. NICULESCU: Yes.

19 THE COURT: Very good. Have a seat. Make yourself

20 comfortable. Has someone provided you with a bottle of

21 water?

22 MR. LEWIS: Apparently not.

23 THE COURT: All right. Mr. Lewis is going to do the honors.

24 Let us know if you need a break at any time.

25 MR. NICULESCU: Thank you.

1 DIRECT EXAMINATION OF PETER NICULESCU

2 BY MR. TRACEY:

3 Q Good morning.

4 A Good morning.

5 Q Would you state your name for the record, please?

6 A Peter Steven Niculescu.

7 Q And what is your current position of employment?

8 A I am a partner at Capital Market Risk Advisors.

9 Q You have provided us, Dr. Niculescu, with your CV,
10 which we've included in that book, I believe, as Claimant's
11 Exhibit 1639.

12 A Yes.

13 Q Is that correct?

14 A Yes, it is.

15 Q Okay. I'd like to ask you about your background first.
16 So, would you start by telling us your educational
17 background?

18 A Certainly. I have an undergraduate degree from the
19 Victoria University of Wellington in New Zealand, a B.A.
20 Honors in Economics. I have Master's Degrees and a PhD from
21 Yale University, with a specialization in finance.

22 Q And, in addition to your education, do you have any
23 professional qualifications or training?

24 A Yes, I am a chartered financial analyst charter holder.
25 I am a chartered financial analyst charter holder.

1 Q And, after you completed your doctorate, did you take a
2 position of employment?

3 A Yes, I did.

4 Q And what was that?

5 A After I completed my doctorate, I went to work at what
6 was then Sanford C. Bernstein Company Incorporated, now part
7 of AllianceBernstein.

8 Q And what was your position there?

9 A My position began as a research analyst, writing models
10 of corporate bond options, long-dated options. And I then
11 became a portfolio manager, investing in corporate,
12 government, and mortgage-backed securities.

13 Q And how long were you at what's now AllianceBernstein?

14 A About 18 months.

15 Q And where did you go after that?

16 A I went to Salomon Brothers, where I worked in bond
17 market research and bond portfolio analysis.

18 Q And specifically what were your responsibilities there?

19 A My responsibilities were in government bond research
20 and corporate bond research.

21 Q And how long were you at Salomon Brothers?

22 A I left Salomon Brothers in early 1990.

23 Q And where did you go after that?

24 A I went to Goldman Sachs.

25 Q And what was your position there?

1 A I entered Goldman Sachs doing work as a corporate bond
2 strategist, sitting on the corporate bond trading desk,
3 advising traders on market opportunities, valuation,
4 hedging, advising the capital markets desk, and also
5 speaking with customers and proposing transactions for
6 customers.

7 Q And did your position evolve at Goldman Sachs?

8 A Yes. In late 1992, I was asked to head the mortgage
9 research group, and oversaw the development of mortgage-
10 backed security research, both for agency product and for
11 non-agency product.

12 Q And did your title at Goldman Sachs change at any
13 point?

14 A Yes, I became a managing director.

15 Q And when was that, if you recall?

16 A I believe it was in 1996.

17 Q And did you continue to run the mortgage research group
18 the entire time you were at Goldman Sachs?

19 A Yes, I did, although I subsequently also took
20 responsibilities as co-head of fixed income research and
21 head of the fixed income research strategy group, which
22 included, for example, asset-backed research, corporate
23 research, emerging markets, and so on and so forth.

24 Q And what were your responsibilities as the co-head of
25 the fixed income group?

1 A That group included all of the technology required to
2 support valuation and modeling, as well as the analytical
3 models that were developed to support transactions, trading,
4 risk management, and hedging, as well as advice,
5 recommendations to clients and customers.

6 Q And your responsibilities as part of the strategy
7 group, what were they?

8 A As part of the strategy group, it was -- the strategy
9 group at Goldman Sachs sat on the trading desks at that
10 time, advised the desks about relative valuations of
11 different asset classes, hedging of those asset classes,
12 risks on the asset classes, and also provided
13 recommendations to the customers, customer base.

14 Q And how long were you at Goldman Sachs?

15 A I left Goldman Sachs in early 1999.

16 Q And where did you go then?

17 A I went to Fannie Mae.

18 Q And what position did you have initially at Fannie Mae?

19 A I took a position as the head of strategy for the
20 company's mortgage and balance sheet holdings. So, all of
21 the assets that were held on balance sheet and funded, I had
22 a position to provide strategy recommendations to the
23 company and risk recommendations to the company.

24 Q And what was the size of that balance sheet?

25 A The size varied, but it was upwards of \$900 billion by

1 early 2002. Early 2002, it was upwards of \$900 billion.

2 Q And did your position at Fannie Mae change?

3 A Yes. In late 2002, I was asked to take direct
4 responsibility for running that position, that book of all
5 our mortgage investments and our liquid investment
6 portfolio, which, as I mentioned, was -- the mortgage
7 investments was upwards of 900 billion. There was another
8 approximately 50 billion of shorter-dated, non-mortgage,
9 liquid investment products, such as asset-backed securities
10 and corporate debt.

11 Q And did you have a trading desk that reported to you at
12 that time?

13 A Yes. We had several trading desks, trading desks who
14 traded mortgage-backed securities, trades -- trading desks
15 that traded mortgage loans. And, on the debt side, we were
16 responsible for debt issuance, calling debt, buying
17 securities for the liquid investment portfolio, asset-backed
18 securities, and so on and so forth.

19 Q And did your responsibilities or position at Fannie Mae
20 change after that?

21 A Yes, it did again. In late 2004, I was asked also to
22 be responsible for the company's capital management. I had
23 earlier, as head of strategy for the balance sheet, had
24 responsibility for the company's risk-based capital
25 calculations, and worked closely with the regulator at that

1 point. Starting in late 2004, I was also asked to take
2 responsibility for the company's preferred debt issuance and
3 management, and oversaw a considerable amount of preferred
4 debt sales in late 2004, and again in 2007 and 2008.

5 Q And did there come a time that you left Fannie Mae?

6 A Yes. I left Fannie Mae a couple of weeks after the
7 company was put into conservatorship, which happened on
8 September 6th, 2008.

9 Q And what position did you take at that time?

10 A I wound up, after a few months, joining CMRA, first as
11 a consultant and later as a partner at CMRA.

12 Q And what is the business of CMRA?

13 A It's -- the business is to advise on risk management
14 and valuation. We have a variety of clients, two principal
15 lines of business. One is to advise financial institutions
16 on risk management practice, to advise their boards of
17 directors. For example, the role of the chief risk officer,
18 correct evaluation of risk, scenario analysis, things of
19 that type. The second role is a litigation support role,
20 advising law firms and their clients on litigation-related
21 matters to complex financial issues, in particular to
22 derivatives, litigation negotiation, and mediation matters.

23 Q And, in the course of your time there, have you been
24 engaged to value credit derivatives?

25 A Yes. We have done extensive valuation work on a wide

1 range of credit derivatives since I have been at CMRA, more
2 than a dozen matters which we have advised clients on for
3 the derivative valuation, either doing the valuations
4 ourselves or reviewing them for clients across hundreds of
5 individual contracts on a client-by-client basis, many
6 thousand contracts overall, where we've looked at and
7 reviewed those valuations.

8 Q I'm sorry, Dr. Niculescu, could you just slow down a
9 little bit?

10 A Certainly. Thank you. Where we have done, reviewed,
11 or performed valuation on several thousand credit derivative
12 products.

13 Q And have you been engaged to provide expert testimony
14 at any time in the past?

15 A Yes, I have.

16 Q On approximately how many occasions?

17 A I have provided expert testimony in Court on two
18 occasions, and I've been deposed on a couple of other
19 occasions.

20 Q Did any of those involve credit derivatives?

21 A Yes. I've given testimony on credit derivatives on
22 behalf of Lehman Brothers International Europe, LBIE. And
23 I've given testimony on credit derivatives in a matter
24 involving the Bank of New York Mellon Trust Company versus
25 Solstice ABS CDO.

1 Q And you also mentioned two matters in which you
2 testified in Court. Could you describe those, please?

3 A Yes. One was several years ago, which is why it's no
4 longer on my CV. It was a matter in London between the
5 Intercontinental Exchange and a trader in sugar contracts, a
6 company called Fluxo-Cane. The matter concerned the
7 liquidation of Fluxo-Cane's sugar positions by the Exchange.

8 Q And the other one?

9 A The other one was more recent. It was last year. It
10 was in a Court in Guernsey and the Channel Islands between
11 the liquidators of Carlyle Capital Corporation and the
12 management and board of directors of Carlyle Capital
13 Corporation.

14 Q And have you been engaged to provide services in
15 connection with the current matter?

16 A Yes, I have.

17 Q And what is the scope of your engagement?

18 A I was asked to do a bottoms-up independent valuation of
19 the PCDS contracts in the matter and the CARB contract in
20 the matter, with a view to calculating a reasonable range of
21 valuations for those contracts, and also to providing
22 opinion on what would be the most reasonable single-point
23 estimate valuation for those contracts.

24 Q Thank you.

25 MR. TRACEY: I would tender this witness as an expert in

1 valuation.

2 THE COURT: All right. Thank you.

3 MR. TAMBE: Can I just have a moment, Your Honor?

4 THE COURT: Yes. Mr. Tambe?

5 MR. TAMBE: Can I get some water here, Your Honor?

6 THE COURT: Yes.

7 BY MR. TAMBE:

8 Q Right. Good morning, Dr. Niculescu.

9 A Good morning, Mr. Tambe.

10 Q Good to see you again.

11 A My pleasure.

12 Q All right, let's just start with some of your
13 background, and then I'm going to ask you some questions
14 about the scope of your opinions.

15 A Yes.

16 Q Those are the two areas in which I will ask you some
17 questions. You went through your work history. You have
18 never been a trader in derivative products, correct?

19 A No, I have had a desk reporting to me that traded
20 derivatives products, and I have myself personally on
21 occasion traded derivative products.

22 Q Let's go through your work history, then. Let's pull
23 up the same exhibit that was up, 1639. And let's start with
24 Sanford Bernstein and Company.

25 A Yes.

1 Q I take it, in that employment, you did not trade any
2 derivatives products, correct?

3 A That is correct.

4 Q Let's go up to Salomon Brothers, '87 to 1990. You did
5 not trade any derivatives products at Salomon Brothers,
6 correct?

7 A Correct.

8 Q Let's go to Goldman Sachs, 1990 to 1999. The positions
9 you had at Goldman Sachs were first in the fixed income
10 research department and then the mortgage research
11 department. Do you see that?

12 A Yes, I do.

13 Q So, neither of those are trading functions, correct?

14 A That is correct.

15 Q And then, when you got to Fannie Mae, you were there
16 from 1999 to 2008. I think you told Mr. Tracey that you may
17 -- you had some traders reporting to you at Fannie Mae, but
18 you were not a derivatives trader at Fannie Mae, correct?

19 A No, no. I had a group of about -- I think, perhaps,
20 about 80 people reporting to me who executed trades for me
21 and for which I was responsible, which I oversaw. That
22 included people who traded derivatives products. I would
23 rarely myself trade those products; it did happen on
24 occasion that, when a very senior person was absent, and I
25 was present, that I needed to and did step in and execute

1 trades myself.

2 Q And the derivatives products you're talking about,
3 those are not credit derivatives, those are other types of
4 derivatives products, correct?

5 A Correct.

6 Q Interest rate derivatives, for example?

7 A That's correct.

8 Q And the product you're opining on, in this case, are
9 full creditor derivatives products, correct?

10 A That is correct.

11 Q Clearly, with respect to PCDS and CARB, you had no
12 particular experience or prior experience trading either of
13 those products, correct?

14 A Indeed, very few people did. I did not. No.

15 Q And CARB and PCDS was not the subject of a research or
16 analysis that you'd ever done prior to this engagement in
17 this case, correct?

18 A I had not completed any research on CARB or PCDS prior
19 to this involvement. I had been aware of another single
20 PCDS contract on behalf of another client, but the client
21 had concluded it wasn't worthwhile doing any research on it.
22 We examined it and did no evaluation of that contract.

23 Q Right. And my question was a narrow question, right?
24 PCDS and CARB was not the subject of any research or
25 analysis that you had done prior to this engagement,

1 correct?

2 A I think that's fair. As I say, I had examined one
3 other PCDS contract on behalf of another client, but had not
4 concluded with any analysis that would lead to an opinion.

5 Q Now you had a team at CMRA helping you do the work you
6 did in this case, correct?

7 A Yes.

8 Q Okay. About 5,000 hours of work?

9 A I think a little bit more than that at this point.

10 Q Not a single individual on that team had ever been a
11 dealer in credit derivatives, correct?

12 A We -- that is correct.

13 Q I think you described it in terms of the scope of what
14 you were asked to do was to create an independent bottom's
15 up analysis, correct?

16 A Yes.

17 Q You are not offering any opinion on the methodologies
18 actually used by QVT to calculate its claim in this case,
19 correct?

20 A That is correct. I'm aware of what they have done. I
21 haven't done the work necessary to formulate an opinion on
22 their methodologies.

23 Q Well, and you're offering no opinion as to whether the
24 methodology that was followed by QVT was a reasonable
25 methodology, correct?

1 A That's correct. Not having done the work necessary to
2 formulate that opinion, I am not in a position to offer the
3 opinion.

4 Q And you're not offering an opinion as to whether or not
5 QVT acted in good faith, correct?

6 A That is correct.

7 Q In response to my prior question, you said you're aware
8 of what QVT has done.

9 A Yes.

10 Q When you submitted your original report in this case,
11 you had not even examined the methodology, correct?

12 A I had examined their results. I am loosely aware of
13 their methodology in some places, but I haven't spent any
14 detailed time thinking about it.

15 Q And in conducting your independent bottom's up
16 analysis, at the very outset of your engagement, you were
17 told what the result was that QVT had obtained, correct?

18 A I was aware of the result they had obtained, yes.

19 Q So before you did a single calculation, you knew what
20 the result was that QVT had obtained, and using the
21 methodologies that QVT had used, correct?

22 THE COURT: Hold on. Yes?

23 MR. TRACEY: Objection, Your Honor. I think this
24 is beyond the scope of (indiscernible). I think we're
25 getting into cross-examination.

1 THE COURT: Why don't you move on, Mr. Tambe?

2 MR. TAMBE: Yes, we'll move on.

3 Q You are not offering any opinions as to what is
4 required by the ISDA master agreement, in terms of either a
5 loss calculation or a market quotation methodology, correct?

6 A My opinion on this matter is not formulated in terms of
7 the requirements from an ISDA master. But I would say that
8 my point estimates and my preferred estimates evaluation and
9 my opinion could well serve as the basis for a loss
10 calculation under the ISDA master.

11 Q In the course of your work, withdraw that. As part of
12 the opinions that you're offering, you're not offering any
13 opinions as to the books and records and valuations on the
14 books and records of QVT, are you sir?

15 A Insofar as those books and records reflect valuations
16 provided by Lehman Brothers, then I am offering opinions on
17 some of those valuations.

18 Q But that's the extent to which you're offering any
19 opinion of those valuations, correct?

20 A As I sit here at this moment, that's all I can recall.
21 Yes.

22 Q And you're not offering any opinion as to QVT's actual
23 losses and costs, as a result of the termination of the
24 Lehman Master Agreement, correct?

25 A Insofar as that is a term that is included in the

1 definition of replacement costs under the ISDA, then indeed,
2 yes, I am offering an opinion of the replacement cost of the
3 PCDS and CARB transactions.

4 Q So in order to give credence to your valuations, your
5 bottom's up valuation, the Court has to conclude that the
6 loss definition includes a two-term replacement cost. Is
7 that right?

8 A My calculations are based on my calculation of
9 replacement cost.

10 Q Okay. And so whether or not that's a relevant
11 calculation for purposes of the loss definition, will turn
12 on whether the Court concludes that replacement cost is a
13 concept included in the loss definition, correct?

14 A My valuations would be different, if they were not
15 conducted on a replacement cost basis.

16 Q And that's the only basis on which you have conducted
17 those valuations.

18 A That is correct.

19 Q Now is it fair to say that on PCDS and CARB, the
20 valuation methodologies you used are different than what you
21 understand the valuation methodologies used by QVT to be?

22 A Yes, indeed. They were created independently, so I
23 should not necessarily expect them to be the same. They
24 were not the same.

25 MR. TAMBE: Your Honor, at this time, we're going

1 to renew our objection pursuant to Daubert, to limit or
2 exclude entirely Dr. Niculescu's testimony. And I'm
3 prepared to argue that further.

4 THE COURT: Okay.

5 MR. TAMBE: But outside the presence of the
6 witness, if possible?

7 THE COURT: Yes. All right, Dr. Niculescu, if you
8 could exit the courtroom for a short while? You will remain
9 under oath, and please do not discuss the case or your
10 testimony with anyone or be in anyone's presence while
11 they're doing the same, all right? And someone will come
12 and let you know when you can come back in.

13 DR. NICULESCU: Thank you.

14 THE COURT: Okay, Mr. Tambe. So all I have --
15 there is very minimal on this --

16 MR. TAMBE: Yeah.

17 THE COURT: -- in the pre-trial brief. So why
18 don't I let you just --

19 MR. TAMBE: Sure.

20 THE COURT: -- elaborate on your position?

21 MR. TAMBE: The starting point is a statement made
22 by QVT in its brief. And I highlighted this in the opening
23 remarks, where on Slide 1, and it's quoting from Page 56 of
24 QVT's brief, QVT said, "Look, the only issue in this case is
25 whether QVT valued the QVT transactions reasonably and

1 good."

2 Now I think on that issue, I think Dr. Niculescu
3 just told us that that is not something he's opining on.
4 He's not opining on QVT's methodologies. He's not opining
5 on QVT's good faith, all right?

6 The other thing that he's not expressing an
7 opinion on is the other part of the loss definition as to
8 whether the calculation that QVT has come up with is in fact
9 QVT's losses and costs.

10 He's done a separate valuation using different
11 methodologies and come up with ranges of numbers and
12 pinpoint numbers. It's a valuation exercise, but it doesn't
13 inform the Court at all in terms of whether what QVT did was
14 reasonable, and whether QVT's methodologies were reasonable
15 methodologies, because he used completely different
16 methodologies.

17 The final point, which is, he conceded that what
18 he's calculated is replacement cost. And the calculation
19 would be very different if he was valuing something other
20 than replacement cost. I think we went through this during
21 the opening.

22 I don't think replacement costs is a term that
23 appears anywhere in the loss definition. If that's all he's
24 done, it's not part of loss definition. Again, I'm not sure
25 what this trial within a trial is all about because we're

1 going to spend a fair amount of time today and tomorrow
2 examining Dr. Niculescu on the methodologies he used to come
3 up with numbers, and whether those are sound methodologies
4 or not.

5 That won't inform you or us at all about whether
6 that says QVT's methodologies are reasonable or in good
7 faith or not. So I think it's completely irrelevant to any
8 issue that actually has to be decided by this Court, and
9 that's a basis under Daubert, to exclude the testimony of
10 Dr. Niculescu and his opinions.

11 THE COURT: Thank you.

12 MR. TRACEY: May I respond, Your Honor?

13 THE COURT: Yes, you may.

14 MR. TRACEY: Your Honor, I don't think we disagree
15 on what the scope of Dr. Niculescu's testimony was going to
16 be here. He spent a huge amount of time and effort coming
17 up with an independent valuation of these two absolutely
18 critical, illiquid securities that are at the center of, and
19 87 percent of the valuation difference between the two
20 parties.

21 And he has developed that entirely independently
22 based on his own review objectively. And that is relevant
23 in this case for several reasons. First, Mr. Tambe said
24 that it is QVT's position that as long as their valuation
25 was reasonable and in good faith, that we win.

1 And that's exactly what we say. Well, Mr. Tambe
2 hasn't agreed to that. Mr. Tambe continues to say, and did
3 in his opening statement, that results have to be reasonable
4 as well. And if Mr. Tambe, on behalf of Lehman Brothers,
5 would like to withdraw that, then I can go onto my next
6 argument. But as --

7 THE COURT: So your point is that one way of
8 demonstrating that the result is reasonable is by showing
9 that you can come up with the same results by a completely
10 different methodology?

11 MR. TRACEY: Correct, Your Honor. And that's well
12 accepted in the law, in specifically relating to ISDA
13 closeouts. So the -- there's the case of Merrill Lynch
14 against UISAF, which is 2012 West Law 1202034, Southern
15 District of New York, Judge Sullivan.

16 It was a case that was very similar to our case.
17 It was an ISDA closeout. There was a default. The non-
18 defaulting party had performed the two steps. First was the
19 market quotation step, just as we did here, and then, a loss
20 calculation.

21 The market quotation did not succeed. There was
22 an argument about whether it had been done properly. The
23 Court found that it had been done properly, and they
24 defaulted to the loss calculation. And Merrill Lynch, which
25 was the non-defaulting party, presented expert evidence in

1 that case, which included three independent objective ways
2 to calculate the losses, which were independent of and
3 different from what the non-defaulting party had presented.

4 And Judge Sullivan accepted -- not only accepted
5 the evidence, but relied on it in making a determination
6 that the loss calculation was reasonable. So that's a very
7 straightforward precedent. This is well-accepted, and we
8 believe that this testimony will be extremely enlightening,
9 not only for that, but overall, for the Court to hear an
10 expert in this field talk about the structure of the market,
11 what was the buying and selling patterns, what's hedging all
12 about.

13 Dr. Niculescu can be very, very helpful, I think,
14 to the Court on the overall concepts in addition to coming
15 up with reasonable ranges for you to compare, where QVT came
16 out. And I would note that actually, there are documents on
17 which Dr. Niculescu relies that weren't available to QVT.

18 So we heard about, for example, a market quotation
19 process that had been done by another counterparty to Lehman
20 in the carve area. That wasn't something that QVT had any
21 access to. Lehman provided to us as part of this case, and
22 of course, Dr. Niculescu considered that in the course of
23 his work.

24 That wasn't something that was available to QVT,
25 but it's very telling, I think, when you hear the valuation

1 and where it comes out, and the fact that if you use an
2 entirely different approach, you come out in the same
3 general neighborhood.

4 THE COURT: So are you saying, though, that if I
5 agree with you and if I agree with Dr. Niculescu, that it
6 would render what QVT actually did completely irrelevant?
7 If QVT, on those two weekends, spent the weekend drawing
8 numbers out of a hat and put those numbers down on their
9 calculation statements, and Dr. Niculescu outlines a
10 detailed methodology that comes to the same number, do you
11 win?

12 MR. TRACEY: No.

13 THE COURT: So I would also have to find that what
14 QVT actually did to calculate its termination amounts was
15 reasonable?

16 MR. TRACEY: Yes.

17 THE COURT: Two separate things?

18 MR. TRACEY: Yes. The only possible exception to
19 that would be if Your Honor determined that the Court needed
20 to make an independent judgment about what the losses were
21 here. For example, not this case, but if market quotation
22 wasn't properly done, the Court might find itself --

23 THE COURT: Hypothetically.

24 MR. TRACEY: Hypothetically, the Court might find
25 itself in a position of having to determine the loss under

1 the ISDA contract itself, based on the evidence that goes in
2 in the course of this trial. I don't think that's going to
3 happen here, but that would be an exception to what you
4 described earlier.

5 THE COURT: So similar to what happened in the Sal
6 Oppenheim case?

7 MR. TRACEY: Right.

8 THE COURT: What about the line of questions that
9 we cut off, the fact that Dr. Niculescu knew where he was
10 supposed to come out?

11 MR. TRACEY: You know, if Lehman wants to make
12 that argument and cross-examine him on it, he's -- they're
13 free to do it. I think the key point is did he perform an
14 objective evaluation? Did he follow standard methodologies?
15 Were they consistent with the literature that he's going to
16 site? And were his judgments reasonable? And I think all
17 of that will show, that these are very, very strong, very,
18 very rigorous valuations.

19 THE COURT: Okay, thank you. Anything, Mr. Tambe,
20 briefly?

21 MR. TAMBE: Just very briefly, Your Honor. I
22 think the point you raised at the very end is a relevant
23 point, which is, he had -- he sort of know -- he knew what
24 the bogey was going in. And even with all of that --

25 THE COURT: Every expert knows what the bogey is

1 going in, right?

2 MR. TAMBE: Yeah, but even with --

3 THE COURT: I mean, it depends -- it doesn't
4 matter what the case is. You know who hires you. You kind
5 of know where you're supposed -- you kind of know the goal
6 that you're driving towards, right?

7 MR. TAMBE: You do, but again, let's put down the
8 context of why he's being offered here. Given that he's not
9 opining on their methodology or good faith --

10 THE COURT: Right.

11 MR. TAMBE: -- the whole reason he exists is so
12 that he can say, "I'm objective and independent."

13 THE COURT: Right.

14 MR. TAMBE: That's the only reason why he has
15 anything, under their view, anything to say here. But that
16 critical, for the threshold element of his analysis is
17 suspect, because he's told on day one, that's the number,
18 right? And even --

19 THE COURT: But on the cross-examination, you're
20 going to go through and you're going to show me --

21 MR. TAMBE: Yeah.

22 THE COURT: -- 16 different ways how if you --
23 bury assumptions or do other things, you get a different
24 answer, right?

25 MR. TAMBE: I'm absolutely going to do that, if he

1 does testify and give his opinions. And that's part of the
2 problem here. We'll do all of that, and what will you have
3 at the end of it? You will have a conclusion that perhaps
4 Dr. Niculescu's valuation methodology, completely separate
5 from QVT's was maybe not reasonable.

6 THE COURT: What about Mr. Tracey's argument that
7 in the event that I have to come up with values on my own
8 for some or all or portions of the portfolio, that it would
9 be -- that that's something I could rely on? To the extent
10 that you don't discredit what he says. You stumped him, Mr.
11 Tracey.

12 MR. TRACEY: (indiscernible).

13 MR. TAMBE: It's like another compliment
14 (indiscernible). Let me confirm that because I'm just -- I
15 want to be careful about how I respond, yeah.

16 THE COURT: Getting a lifeline.

17 MR. TAMBE: Yeah. I'm --

18 THE COURT: I think we're going to have to wait
19 and see what happens, because I, despite Mr. Tracey's
20 optimism, I can't rule out the possibility that as to one or
21 more buckets of the positions that need to be valued, that I
22 might end up having to be writing on a clean slate.

23 I, as I'm sitting here right now, don't have in my
24 mind all of Lehman's experts, and the subject matter on
25 which they're going to opine.

1 MR. TAMBE: But I think, and that's -- now that
2 I've had a few minutes to think about the problem of that.
3 They have the obligation, as a non-defaulting party, to
4 reasonably and in good faith come up with a number as a
5 loss.

6 THE COURT: Yes.

7 MR. TAMBE: If they fail to do that, as you
8 conclude --

9 THE COURT: Right.

10 MR. TAMBE: -- that you can't rely on their
11 numbers because you conclude either they weren't in good
12 faith or they weren't reasonable or whatever reason.

13 THE COURT: Right.

14 MR. TAMBE: I don't think necessarily the next
15 place you go is to say, "Well, who else has given me a
16 reasonable number?" because we know from Mr. Gold's
17 testimony yesterday, which I thought was quite remarkable,
18 no hit to that.

19 There is an answer available, but there were no
20 losses of costs incurred by QVT. Yes, you've got this
21 hypothetical calculation of a replacement trade, and he
22 described it in a way, that again, was fairly remarkable,
23 lost profit opportunities of what they could have earned,
24 had the trades not been terminated, right?

25 That -- none of that's got anything to do with

1 what Dr. Niculescu's testifying about. And that's the other
2 problem, so even --

3 THE COURT: Well, I don't agree. I mean, first of
4 all, QVT will, I'm quite sure, will characterize that
5 testimony very differently. But putting that to one side,
6 there are -- we have heard testimony about subsets of trades
7 that, for example, didn't make their way into market
8 quotation.

9 MR. TRACEY: Right.

10 THE COURT: And then, we have heard about
11 different subsets of trade as to which a market quotation
12 did not succeed.

13 MR. TRACEY: Yeah.

14 THE COURT: So I don't know at this point,
15 frankly, what the answers are with respect to the extent
16 that I find myself in a position of needing or of
17 disagreeing with QVT's valuation. What happens?

18 So I hear your reservations about this. I don't
19 think it rises to the level of a Daubert exclusion.
20 Frankly, and I'll say this to Mr. Tracey, it's not about the
21 fact that he's done an extraordinary amount of work, that
22 you know, that if anything, will go to the rigor and, of his
23 analysis, maybe.

24 MR. TRACEY: I'd argue the opposite. I could just
25 --

1 THE COURT: Well, you know, you're free to do
2 that, but I'm not there in terms of excluding him on a
3 Daubert challenge. And I'll be very interested to hear your
4 cross-examination.

5 MR. TRACEY: Sure. No pressure, though.

6 THE COURT: No pressure. So --

7 MR. TRACEY: Very well.

8 THE COURT: Do you want to take you until one
9 o'clock, Mr. Tracey?

10 MR. TRACEY: Sure.

11 MR. TAMBE: There's a (indiscernible) issue I want
12 to discuss before he takes the stand, a small point. Your
13 Honor, there's just one issue we want to discuss?

14 THE COURT: Yes?

15 MR. TAMBE: We received last night their
16 demonstrative deck for Dr. Niculescu.

17 THE COURT: The one that I was handed?

18 MR. TAMBE: Yeah. And on Page 7, there's an
19 analysis of Bloomberg pricing, which I believe is identical
20 to the analysis in the rebuttal report on Page 71, Exhibit
21 14.

22 THE COURT: Okay.

23 MR. TAMBE: So we've got that issue again of
24 whether he's going to talk about his original report or if
25 he's going to talk about the rebuttal issues before our

1 experts have even testified.

2 THE COURT: I thought we had an agreement that
3 rebuttal was going to wait until rebuttals --

4 MR. TRACEY: Well, the rebuttal absolutely will
5 wait, and virtually everything that he's going to testify
6 about is in his initial report. This particular slide
7 doesn't rebut anything that was in the Lehman reports.

8 THE COURT: The Lehman report?

9 MR. TRACEY: In other words, he doesn't have to --
10 he's not going to say, "And the Lehman expert said X, and I
11 disagree with that." This is just part of his thinking as
12 to why he couldn't use these prices.

13 He didn't put it in his report until the rebuttal
14 report, because he -- I don't think he knew that it -- there
15 was going to be a challenge on it, but it is part of his
16 initial thinking. And --

17 THE COURT: But that just sounded -- what you just
18 said sounds like rebuttal.

19 MR. TRACEY: Well, it's -- it was put in in the
20 rebuttal report, but it was part of his thinking in the
21 initial process, in other words, why not use these prices?
22 I don't -- frankly, it doesn't matter to me if he says it
23 now or later. I think it's a little more coherent for the
24 Court to hear his discussion of this.

25 THE COURT: Is there -- can you link this to

1 something in his opening report?

2 MR. TRACEY: It's just why he didn't choose to
3 rely on prices in the market. And --

4 THE COURT: Is that in and of itself in the
5 opening report?

6 MR. TAMBE: I don't think that issue is addressed
7 in the opening report. When he says, you know, "There's a
8 price in the market, but I'm not using them because of
9 something like Page 7 of the demonstrative."

10 MR. TRACEY: I --

11 MR. TAMBE: It's a long report, though, so --

12 MR. TRACEY: Yeah, I'd have to look.

13 THE COURT: I'll tell you what. Why don't I let
14 you get started?

15 MR. TRACEY: Okay. And --

16 THE COURT: And then, hold this or carve it out.
17 And then, over the lunch break --

18 MR. TRACEY: Perfect.

19 THE COURT: -- you can take a better look. You
20 can attempt to find something in the opening report that
21 this is linked to. You can either work it out or we'll
22 figure it out after we come back.

23 MR. TRACEY: Okay.

24 THE COURT: So for the purposes of keeping it
25 clean, why don't you just rip this page out from his version

1 of the deck, and then we can give it back to him, if we
2 figure out that's appropriate? Thank you. Welcome back.

3 DR. NICULESCU: Thank you. I take it I may
4 proceed.

5 MR. TRACEY: We just would note that we did take
6 one page, Page 12, out of your book, so don't --

7 THE COURT: Seven.

8 MR. TRACEY: Oh, Seven, excuse me. So don't
9 expect to see it there.

10 DR. NICULESCU: Ah yes. That's (indiscernible),
11 thank you.

12 Q Okay. Dr. Niculescu, I'd like to start with the CARB
13 product. Is that a product on which you've done work and
14 provided evaluation?

15 A Yes. It is.

16 Q And what is the CARB product?

17 A CARB stands for CDS on auto receivables. It was a
18 product created by Lehman in 2007, apparently, to try to
19 catalyze derivative trading in auto asset-backed securities.
20 Analogous to the trading that had been catalyzed in the
21 subprime MBS sector through the development of the AVX.HE
22 Indexes.

23 It contained eight reference entities, the
24 underlying components were CDS on auto ABS. The only CARB
25 that traded was a triple-B CARB, although others were

1 offered. And so, I will just be talking about the triple-B
2 CARB at this point, that referenced subordinate tranches of
3 those auto ABS.

4 Q And in general terms, what was QVT's position in CARB?

5 A QVT was one of the larger participants in the CARB
6 market. They had wanted to buy protection on the auto ABS
7 sector by buying protection from Lehman and CARB.

8 Q And in what amount?

9 A They had a net position at the -- by the end of their
10 transactions of \$80 million, although they had purchased
11 larger quantities earlier on and then sold them back.

12 Q And have you performed a valuation of that position as
13 of September 15, 2008?

14 A Yes, I have.

15 Q And before we get into the details of it, I wonder if
16 you could just high level, take us through the process that
17 you followed and the result that you got?

18 A Yes. I would like to do that by moving to the first
19 slide, which is Page 3 in my book, which is an overview of
20 the method that I used to value QVT's CARB position. It was
21 made easier by the fact that I had a market quote from
22 Merrill Lynch, an unqualified market quote, that was
23 provided to me by Lehman, where they quoted an offer to sale
24 protection to the one other counterparty that at the time
25 had a long position in the protection in CARB.

1 The other counterparty had a position of only \$15
2 million, which was much smaller than QVT's position of \$80
3 million. Merrill Lynch provided that quote in spread terms.
4 So basis point premium, perhaps 1,200 or 1,400 basis points
5 per year of spread.

6 As Mr. McDougall said, that spread then has to be
7 converted to price, so I did that conversion. Then, I
8 needed to do an adjustment for the size of the position from
9 \$15 million up to \$80 million.

10 And doing those two fairly simple steps, results
11 in a valuation of the QVT's position of between \$29 and \$36
12 million. QVT's valuation was \$37 million.

13 Q Okay. Before we get into the details, I'd like to just
14 ask you some general questions. First of all, in your -- in
15 the book in front of you, we've marked as Claimant's Exhibit
16 1637, what I believe is your initial report in this matter.
17 Could you identify that, please?

18 A Yes, that's correct.

19 Q And did you write that report?

20 A Yes, I did.

21 Q And did you have assistance in writing that report?

22 A Yes, I did.

23 Q And could you describe generally what assistance you
24 had?

25 A Yes. I have a team of people who assisted me on this

1 matter directly at CRMA, one of whom was a specialist in
2 credit derivative products, having traded several billion
3 dollars of credit derivative products as an investor. And a
4 number of other assistants who worked with me on developing
5 analytics and looking through documents and data. I also
6 used assistance from an external company, Numerics, that
7 specializes in creating financial algorithms for valuation
8 work.

9 Q And were you provided documents in connection with your
10 work in this matter?

11 A Yes, a considerable volume of documents.

12 Q Would you describe for the Court in general terms what
13 categories of documents you were provided and reviewed?

14 A Yes. Goodness. I received documents, all of the
15 documents in the matter from QVT and from Lehman. In
16 addition, there was considerable third party disclosure
17 through their subpoena process. I understand many -- most
18 of the large banks were subpoenaed by -- in this matter, and
19 I've seen a large volume of documents from them.

20 And there were many other types of documents that
21 I looked at. For example, trustee reports on some of the
22 underlying securities. I went out to try to find market
23 data, market pricing from Bloomberg, from IDC and other
24 sources, Market Partners. I reviewed academic literature
25 and papers on valuation techniques. And finally, I looked

1 for market commentary, contemporaneous market commentary
2 from traders and research at the time describing market
3 conditions.

4 Q Did you review any academic or industry research or
5 literature in connection with your work?

6 A Yes, yes, I did.

7 Q And what kind?

8 A So there was research published on the relevant sectors
9 of the preferred market and the auto and consumer ABS
10 market. I reviewed the contemporaneous publications from
11 the street industry research on those markets. There were
12 also academic papers on valuation techniques. And I went
13 through the literature on valuation techniques to ensure
14 that we were consistent with current thinking of valuation.

15 Q And can you estimate approximately how many documents
16 you reviewed all told in connection with this engagement,
17 you or your team?

18 A I haven't done that estimate. It must be at least in
19 the hundreds of thousands, though.

20 Q And did you review any deposition testimony?

21 A Oh yes, I also reviewed deposition testimony and trial
22 testimony.

23 Q And have you reviewed other expert reports in this
24 matter?

25 A I have reviewed the other expert reports in this

1 matter, yes.

2 Q And approximately how many hours have you and your team
3 spent on this engagement?

4 A Yeah, I think it's more than 6,000 hours at this point.

5 Q And is there any way to divide that up generally
6 between CARB and PCDS?

7 A I haven't been able to do a precise estimate of that
8 division. PCDS was considerably more complex than CARB.
9 The CARB valuation was simple, although it took quite a lot
10 of work to research the market environment. I would provide
11 a rough estimate that the time spent on CARB would be
12 between 1,000 and 2,000 hours out of those 6,000.

13 Q Okay. So let's go back to CARB, and I'd like to ask
14 you some general questions about the trading in CARB. Did
15 you, as part of your analysis review the trading by Lehman
16 in the CARB product?

17 A Yes, Lehman helpfully provided us with the trade log in
18 CARB. And the next slide demonstrates that trade log. This
19 is what Lehman calls their net, what was the net CARB
20 position that was reported through our taking that trade log
21 and working through it. The way it's captured here is that
22 the CARB is an index, so a negative value means that Lehman
23 has sold the index short. A positive value means they own
24 the index. When Lehman sells the index short, Lehman buys
25 protection on the index. When they own the index, they have

1 sold protection on the index.

2 So looking at this picture, this is their net CARB
3 position, as a result of the transactions they did. You'll
4 see that their first transaction that we see reported here
5 was in October 2007, early October 2007. When they sold \$50
6 million of the index, they bought protection of \$50 million
7 of the index.

8 They apparently covered that protection quite
9 quickly, and then went out and bought the index to \$25
10 million. And from then on, you'll see that their net
11 position stayed within a fairly narrow range, diverged a
12 little bit in March of 2008, but generally stayed within
13 plus or minus \$15 or \$20 million of notional, and for the
14 last month or so, was essentially flat.

15 Q And have you looked at the trading to see what the
16 trading was of QVT and other counterparties?

17 A Yes, I have. And the next exhibit shows that. Here, I
18 have gone back to Lehman's trade log and pulled out the QVT
19 transactions. This is Lehman's historical trading, over all
20 the entire life history of the CARB. QVT, on a gross basis,
21 had bought \$170 million notional of protection on CARB, then
22 sold back \$19 million, so they had a net position at the end
23 of the period of \$80 million.

24 Interestingly, QVT had bought more protection than
25 all of the other counterparties put together, which was only

1 \$126 million. They were more than half of the market for
2 protection purchases over that entire time period.

3 Q And are -- were there any dealers that you found, who
4 were making a market in CARB other than Lehman?

5 A No. I looked at that quite carefully, and I'm
6 confident that there were no other dealers making the market
7 in CARB.

8 Q And what do you base that on?

9 A Well, several facts. First, we saw, I think earlier
10 today in Mr. McDougall's testimony, an email from Market
11 Partners. Lehman had approached Market Partners to ask them
12 if they would sponsor or would be involved with the CARB
13 index, as they have been with the subprime mortgage index.

14 In order to do that, Market Partners needs to get
15 prices daily from the dealer community, and they are
16 reported -- Market reported back that they were unable to
17 get those prices from the dealer community. From my
18 experience, if the dealer community's unwilling to price
19 something daily, then they're not really willing to make a
20 market on it.

21 Sometimes, they may price it without making a
22 market, but if they're making a market, then they will
23 certainly price it. So I think that was fairly clear, that
24 they were not going to -- the dealer community outside of
25 Lehman was not going to be involved in CARB.

1 Secondly, I heard Mr. McDougall say that he
2 doesn't believe that anybody else in the dealer community
3 was making a market in CARB. And I'm not surprised at that.
4 Indeed, we'd gone through all of the thousands of pages of
5 documents provided under subpoena, which referenced the
6 subpoena's reference CARB. And we have not found anything
7 on that record from the dealer community that suggests that
8 they were active in CARB.

9 And lastly, the other counterparty, QVT had a net
10 position at the end of \$80 million. The other counterparty
11 had a position of \$15 million. The other counterparty did
12 solicit market quotations, and they, in their summary to
13 Lehman of the results of that process, they noted that
14 Lehman was the only trader in the product. So I am
15 confident that there were no other market makers or dealers
16 active in making a market in CARB at this time.

17 Q And what is the significance, if any, to your valuation
18 that there were no other dealers trading in CARB?

19 A It means that the other dealers, if they took on a CARB
20 position would have not been confident that they could
21 resell that position to another party. They might have had
22 to expect to hold the risk position potentially for a
23 considerable period of time, as there wasn't an active
24 market in CARB.

25 It helps explain why the cost of protection could

1 go up very substantially, where -- in order to find a
2 replacement, because the dealer who would sell you
3 protection would be unable to resell that protection. They
4 also would be unable to hedge it.

5 So it explains a reluctance on the part of dealers
6 to offer to sell protection to offer to sell protection and
7 underpins what might otherwise seem to be very high
8 valuations. It explains those valuations.

9 MR. TAMBE: Your Honor, we move to strike the
10 testimony as to what dealers would have done, whether
11 (indiscernible) been confident. We'll be establishing
12 (indiscernible) that his experience is not based on his work
13 as a dealer, nor does he have any particular experience in
14 dealers in this market. He could talk about how he did his
15 valuation, but in terms of what other dealers did or must
16 have done or must have thought, I think there's absolutely
17 no basis for it. We move to strike that, Your Honor.

18 MR. TRACEY: I have a response, but I hesitate to
19 have an open discussion on this.

20 THE COURT: I agree.

21 MR. TRACEY: Maybe if we can --

22 THE COURT: Can you move on and we can come back
23 to the point?

24 MR. TRACEY: I'm done with that, and we can argue
25 when --

1 THE COURT: All right, let's move on and we can
2 come back to that point.

3 Q Dr. Niculescu, did you review as part of your
4 valuation, the marks that were placed on CARB by Lehman?

5 A Yes, yes, I did.

6 Q And what did you find when you reviewed Lehman's marks
7 on the CARB product?

8 A Lehman provided daily marks to QVT. Those marks
9 included accrued interest. When you take out the accrued
10 interest, you see the marks in fact never changed from early
11 July through September, there was the mark on the protection
12 that QVT owned was always 16 percentage points.

13 Now Lehman made offerings in the market, a two-way
14 market, bids and offers from time to time through this
15 period. The last one they made was on August 21st. We show
16 it here at that time, Lehman made an offer to sell
17 protection at 23 and to buy protection at 19. The midpoint
18 is therefore 21 percent. It's the midpoint that is useful
19 as a comparison to Lehman's daily marks.

20 It was considerably different than Lehman's daily
21 marks, and their market offers changed from time to time.
22 The daily marks did not. I therefore concluded that their
23 daily marks are not reliable on the occasion of where Lehman
24 itself had placed the market for CARB.

25 Q Okay. I'd like to turn, if I may, to the methodology

1 that you used to value the CARB product. Can you explain to
2 the Court your overall approach to the valuation before we
3 get into the specifics of what you did here?

4 A Yes. I think this is valid for valuing really any
5 fixed income product and any derivative product. At base,
6 you are looking for actual market prices on some product
7 that bears some relation to the product you are trying to
8 value.

9 If you can get a price on the exact product you
10 are trying to value, then that's what you use. If you
11 can't, you try to find prices on products that are
12 relatively similar, and then by a process of interpolation
13 or extrapolation, derive the price of the product that you
14 are trying to value.

15 For example, in the derivatives, you may have a
16 four-year credit default swap and see prices for three-year
17 and five-year credit default swaps, and say, we'll
18 interpolate between them to price the four-year credit
19 default swap.

20 In other cases, you may not have any prices for
21 credit default swaps, you may need to go to the price of an
22 underlying security in order to impute what the price of the
23 credit default swap is. But the basic principle is to try
24 to look for market prices and then find an analytically
25 rigorous way of extrapolating or interpolating from those

1 prices to the price of what it is you are trying to value.

2 That's the general procedure.

3 Q Okay, thank you. And I'm just noticing that the court
4 reporter is struggling to keep up, so we both have to be a
5 little slower.

6 A I appreciate that.

7 Q Okay. So following up on your methodology, were you
8 able to find any actual transactions in the CARB product
9 that you could use as a price source for your valuation?

10 A No, there were no actual transactions, but there were
11 market quotes provided in CARB at the relevant time.

12 Q And did you use a, quote, "quotation," for your
13 methodology?

14 A Yes, yes, I did.

15 Q And what quotation did you use?

16 A The next page shows the market quotes received by the
17 other counterparty that was long protection with Lehman,
18 CARB Party A. They had requested market quotes for a \$15
19 million size position from Citigroup, from Merrill Lynch,
20 and from RBS.

21 Q Why don't we take a look at that? Maybe I'll bring up
22 Joint Exhibit 73, John? Do you recognize that as the market
23 quotation that you relied on?

24 A Well, yes. This is provided by CARB Counterparty A as
25 a summary that they gave to Lehman of the quotes they

1 received. As we see, it says, "Only markets are traded by
2 Lehman." And we have the eight component parts of the CARB.
3 Caret refers to a GMAC-issued security, Ford owed to a Ford
4 Motor credit-issued security. I'm so sorry. Thank you.
5 Caret refers to a GMAC-issued security. And Ford owed to a
6 Ford Motor credit-issued security.

7 So reading across the first line, "2006-1D, this
8 is the first deal issued by GMAC and ABS in 2006 and this is
9 the D tranche, the most subordinate of the tranches." And
10 then, we have a Citibank priced quote of 95. That is given
11 in index equivalent terms, which means that the price of
12 protection would be 100 minus 95 or five points.

13 Going to the far right, we see RBS, the Royal Bank
14 of Scotland. They had a price quote of \$85, meaning the
15 price and protection would be 100 minus 85 or 15 points. In
16 the middle, we see Merrill Lynch. They provided spread
17 quotes instead of price quotes. The first one is 1,250
18 basis points, which is the premium that Merrill Lynch would
19 have charged to sell protection on the caret 061D's.

20 And you see the other spread quotes down the page
21 for the other component parts. The CARB Counterparty A then
22 provided a price that they calculated, which converted the
23 Merrill Lynch spread quote into a bond price equivalent.

24 Q Why don't we take a look at each of those quotes
25 individually? In your book, could you turn within Joint

1 Exhibit 73, to Page 1807? Do you have that in front of you?

2 A I do.

3 Q And can you explain for the Court what you understand
4 this to be?

5 A Yes. So this is an email from RBS, Royal Bank of
6 Scotland Greenwich Capital Markets, and it is in a response
7 to a question. And we see the question here. It says, "Hi,
8 I'm looking to buy protection on the following list of
9 names, and equal proportions AON," which stands for all or
10 none, "at 150 basis points running, fixed cap and implied
11 right down.

12 Now these are the terms and conditions of the CARB
13 contract, 150 basis point running premium which a fixed cap
14 and an implied right down structure. Where could I do this
15 in terms of points upfront? Total size is \$15 million."

16 RBS responds with the points up front for each one
17 of the component parts, as they have to, because it's an all
18 or none request. The first component part is 15 points.
19 That corresponds to the 85 points we saw in the previous
20 page.

21 Interestingly, RBS says at the top, "These
22 indications are good for today," which is a -- and this is
23 on September 16th at 10:49 a.m., this is an interesting
24 statement. On the one hand, it includes the word
25 indication, which suggests that the levels may not be firm.

1 On the other hand, it says these -- they're good for today,
2 which suggests that the levels may be firm.

3 THE COURT: Mr. Tracey, I'm sorry, but I don't
4 know what --

5 MR. TRACEY: Am I confusing --

6 THE COURT: I don't know what this is.

7 MR. TRACEY: Okay, okay. Let me --

8 THE COURT: I mean, I can read the words on the
9 page, but I just don't -- maybe I missed it.

10 MR. TRACEY: Sure.

11 THE COURT: But I don't know what this is.

12 MR. TRACEY: Sure, let me --

13 THE COURT: To, from.

14 MR. TRACEY: Sure. Let me back up. Apologies,
15 Your Honor.

16 THE COURT: No, it's me. It's not you.

17 Q So, Dr. Niculescu, can you describe, in general terms,
18 what you understand Joint Exhibit 73 to be?

19 A Yes, yes, indeed. Joint Exhibit 73 describes the
20 results of the market quotation process that CARB Party A
21 conducted.

22 Q And before you go on, could you state who CARB Party A
23 is, without using their name?

24 A It is another fund or a hedge fund that had a position
25 with -- where they had purchased protection on CARB from

1 Lehman, in a size of \$15 million notional.

2 Q So were they in this -- in the same position as QVT in
3 regard to their position in CARB?

4 A They were on the same side of the market as QVT. There
5 were only two counterparties that held -- that owned
6 protection on CARB from Lehman. CARB Fund A and QVT. There
7 were two or three on the other side of the market, but only
8 two that owned protection.

9 Q Okay. And so, is it your understanding that as a
10 result of Lehman's filing, the positions of CARB
11 Counterparty A were terminated?

12 A That would be -- yes, that would be my understanding.

13 Q Okay. And that -- and this would be their market
14 quotation solicitation?

15 A Yes.

16 Q Okay. And who did CARB Counterparty A reach out to for
17 a market quotation solicitation on CARB?

18 A They reached out to three counterparties, to Citigroup,
19 to Merrill Lynch, and to RBS.

20 Q Okay. And what was the volume that they were asking
21 for prices on?

22 A \$15 million.

23 Q Okay. And did they get responses from those three
24 dealers?

25 A Yes.

1 Q Okay. And do you understand Joint Exhibit 73 to be the
2 responses that they received?

3 A Yes.

4 Q Okay. And how did you get a hold of this document?

5 A This document was provided to us by Lehman.

6 Q Okay.

7 MR. TRACEY: Your Honor, have I fixed my problems?

8 THE COURT: So on Exhibit 0073, and we're looking
9 at the Page that ends in Bates 807, there is a block of text
10 that says, "Hi, I am looking to buy protection." So is --
11 that was -- what you're saying is, that that's the substance
12 of the market quotation?

13 DR. NICULESCU: Yes.

14 THE COURT: And you were able to discern from the
15 documents that you reviewed, that that request went out to
16 the three parties that you identified?

17 DR. NICULESCU: Yes.

18 THE COURT: And the answer came back to the MQ
19 process from this page, from RBS, with these indications?

20 DR. NICULESCU: That's correct.

21 THE COURT: So did the original -- so when it came
22 back, was the pricing inserted? I'm just trying to
23 understand literally what went out in the -- when Mr. Chaney
24 says, "These indications are good for today," that refers to
25 the plus 15 points upfront on the caret 06?

1 DR. NICULESCU: That's -- that is correct.

2 THE COURT: Okay. So the original document that
3 went out -- maybe I'll ask Mr. Tracey.

4 MR. TRACEY: We don't have that document --

5 THE COURT: Okay.

6 MR. TRACEY: This is the only thing we got. But
7 we expect --

8 THE COURT: I -- well, that's what I'm --

9 MR. TRACEY: Yeah.

10 THE COURT: That's my confusion, okay?

11 MR. TRACEY: Right. We expect that what this was,
12 was a -- the hi and the text were the request from CARB
13 Counterparty A, which is the other party in QVT's position.

14 THE COURT: To the market.

15 MR. TRACEY: To the market, asking for quotes.

16 THE COURT: Right.

17 MR. TRACEY: And the -- it probably listed the
18 eight --

19 THE COURT: The eight CARB securities.

20 MR. TRACEY: CARB securities, right. And said,
21 all or nothing, I'd like a quote on CBS's on these eight.

22 THE COURT: So when it came back --

23 MR. TRACEY: It would have the numbers.

24 THE COURT: It would have the numbers, okay.

25 Having used up the available time to (indiscernible)

1 confusion, we're going to have to stop there, all right, so
2 that I could dial into my call. We'll come back in an hour,
3 all right? And you'll have to remind me at the top, if Mr.
4 Tambe, if you still want to take up that last objection.

5 MR. TRACEY: Yes, Your Honor.

6 THE COURT: All right?

7 MR. TAMBE: Okay.

8 THE COURT: We'll see you in an hour.

9 MR. TAMBE: Thank you.

10 THE COURT: The same rules apply over the lunch
11 break.

12 DR. NICULESCU: Thank you, Your Honor.

13 (Recess)

14 MR. TAMBE: Before we start, if you could take up
15 the objection from before the lunch break?

16 THE COURT: Yes.

17 MR. TRACEY: We'll just save it for rebuttal, it's
18 not a problem.

19 MR. TAMBE: Different point.

20 THE COURT: Different point.

21 MR. TRACEY: Oh, okay.

22 THE COURT: I think it was the, about the
23 testimony, about that one answer. Hold on a second. All
24 right, so we had left off with my forcing you to explain
25 page (indiscernible) in Bates 807, and that's where we had

1 left off.

2 Q Thank you, Your Honor. Let's go back to Page 807,
3 which I think you said was a market quotation submitted by
4 RBS in response to Counterparty A's request, is that
5 correct?

6 A Yes, that's correct.

7 Q And what I'd like to do, if I can, is focus you on the
8 nnumebers that are on the column in the middle of the page,
9 and ask you to interpret them for us. What is it that you
10 understand these numbers to mean, in terms of the price
11 that's being quoted by RBS?

12 A Certainly. The contract is a contract for a credit
13 protection at 150 basis point running premium. With that in
14 mind, the -- RBS's offering to sell to somebody protection
15 on the 061D tranche of caret, caret 061D for a price of 15
16 percentage points up front. So the buyer of protection will
17 pay 15 percent up front, and 150 basis points, running,
18 while caret 06 -- well, caret 071C, they'll charge a full 80
19 points up front, (indiscernible) 07A, they'll charge 55
20 points up front.

21 The CARB consists of these eight components, and
22 so if you simply average the points up front, the average
23 points up front is the price at which RBS is prepared to
24 sell protection to CARB Fund A in a \$15 size notional. Now,
25 you average them, I think the total is 42.5, so they're

1 asking for 42.5 percent of \$15 million in order to sell
2 protection to Fund A. Fund A will then also pay 150 basis
3 points per year, running (indiscernible) on that notional.

4 Q And I don't have a calculator here, but, so would it be
5 fair to say that RBS is saying, If you pay me about \$7
6 million, I will sell you protection on \$15 of these eight
7 underlying CDSes?

8 A Approximately, yes.

9 Q Okay.

10 THE COURT: Dr. Niculescu, when you reviewed this
11 data, did you do anything independently to -- I'll use the
12 word vet it, or verity it?

13 DR. NICULESCU: Yes, yes, I did.

14 THE COURT: What did you do?

15 DR. NICULESCU: I did a couple of things. Looked
16 at the circumstances surrounding these offerings being made
17 by these counterparties, to see whether the offerings appear
18 to be reasonable in the context of current market
19 developments, and in the context of what has happening in
20 September 2008. I looked at market commentary on yield
21 spreads, or prices for other consumer ABS products. I
22 looked at market commentary about the shape of the market,
23 the state of the market. I looked at the fundamental
24 economic developments. I considered the credit-worthiness
25 and credit support of each one of these tranches.

1 THE COURT: I simply meant with respect to what
2 was sent by RBS, not -- your answer gets more generally into
3 topics I'm sure Mr. Tracey is going to cover, but --

4 DR. NICULESCU: I only have the worlds on the page
5 in front of me, Your Honor.

6 THE COURT: Thank you.

7 Q Okay. so let's -- we've talked about one of the three
8 market quotations that was received. I'd like to now turn
9 to the second one, and direct your attention to Page Lehman
10 QVT 61806, can you turn to that page?

11 A Yes.

12 Q And would you describe for the Court what you
13 understand that page to be reflecting?

14 A This is the response from Citi, to the same request.
15 And Citi has written their points up front. They say in the
16 text (indiscernible) levels below, our points up front,
17 assuming 150 basis points running. So now it gets to the
18 RBS quote, but at very different, much lower levels.

19 Interestingly, importantly, Citi says level
20 indications only as of 9/16. I take that to mean that these
21 are not actionable or executable levels. If I saw that
22 given to me when I requested a quotation, I would not expect
23 to be able to act on that information.

24 Q Okay. And again, the numbers that are next to each of
25 the underlying components, those represent upfront costs

1 that Citibank is saying they would charge for protection for
2 each of those underlyings?

3 A That's correct, yes. Our points upfront, yes.

4 Q Okay. And in the same way, if you wanted to figure out
5 how much you would have to pay Citibank for protection, you
6 would average those percentages, multiply it by 15 million,
7 and you'd get the price?

8 A That's correct.

9 Q Now, let's turn to the third quotation, which I gather
10 is more complicated. It's the quotation that's on 61808.
11 Could you describe for the Court what that page represents?

12 A Yes, this is a response from a couple of people at
13 Merrill Lynch. The most significant part of the response, I
14 think, follows the same question that was posed to RBS, the
15 very same words, "Hi, I'm looking to buy protection on the
16 following list of names," et cetera. What Merrill Lynch has
17 done is they've filled in data on each one of these eight
18 component parts. But instead of conveniently giving us
19 points upfront, they've given us a basis point spread, which
20 is in the case of caret 061D, 1251 basis points.

21 They also show the rating of each one of those
22 underlying bonds, and what I believe to be the weighted
23 average life. So caret 061D was rated AAA/AA/A, and had a
24 weighted average life of 1.81 years. Also on the page, as
25 you go further up, there's some other conversation that

1 Tracy Keegan responds to with a 7CPR. I don't know exactly
2 what that, the significance of that is. But what we do have
3 is we have in the body, starting at the valuation, or the
4 pricing on the caret 061D, a series of spreads, or
5 (indiscernible), starting at 1250 basis points, and going
6 through 1600 and so on through the end.

7 And these are the premiums that Merrill Lynch is
8 saying that they would charge in order to sell protection on
9 each one of these component parts. So it's 150 basis points
10 running spread. They would charge the 1250 on the 061Ds,
11 1600 on the 062Ds, a simple average of these numbers is 1450
12 basis points.

13 Q And so just to make sure we understand, let's take the
14 caret 061D, the first one, and Merrill Lynch is saying --
15 correct me if I'm wrong, if you want to buy protection on
16 this component, you'll have to pay me 12.5 percent per year.

17 A Yes, that's right. You'll have to pay be 12.5 percent
18 per year. The current contract was written at 150 basis
19 points. That's no longer a market level. Merrill Lynch now
20 wants 1250 for caret 061D, it wants 1450 for the collection
21 as a simple average, for the eight.

22 Q Okay. And so unlike the other two, it does not have a
23 points upfront, is that correct?

24 A That's correct.

25 Q Okay. So how did you --

1 THE COURT: I'm sorry to interrupt you, but the
2 column that has the years?

3 DR. NICULESCU: Yes.

4 THE COURT: Can you explain again what that
5 indicates?

6 DR. NICULESCU: I think it almost certainly
7 indicates the weighted average life of each one of the
8 underlying bonds. Now, that's not noted on the sheet. But
9 the column is very close to whatever computer's a weighted
10 average life. And the reason that I come to this conclusion
11 is that what Merrill Lynch appears to have done is it's
12 taken descriptive information on each one of these bonds off
13 a database, and populated that descriptive information onto
14 the sheet here. This is not an unusual thing to do, people
15 do this.

16 THE COURT: Okay, so then the basis points that it
17 quotes are what it would pay per year, in order to sell the
18 protection?

19 DR. NICULESCU: That's right, that's correct.

20 THE COURT: So then, but then you say that you did
21 a simple, arithmetic average.

22 DR. NICULESCU: Right.

23 THE COURT: But how could that be the case when
24 each of the lines runs for a different period of time? In
25 other words, on the Caret 061D, the life, if you will, is

1 1.81 years at 1250 basis points, but then you go down to the
2 Caret 072, where they're charging 1600 basis points, the
3 life is 3.56 years. If that's a stupid question, you can
4 (indiscernible) --

5 DR. NICULESCU: No, not at all, that's a more
6 educated question. The answer is the simple average is
7 nothing but a simple average. The correct way of averaging
8 these spreads is to weight them by the duration of each of
9 the component parts.

10 THE COURT: Yes.

11 DR. NICULESCU: If I do that, the average is,
12 depending on the way I -- depending on the exact way that I
13 would (indiscernible) for projections is about 1492 basis
14 points.

15 THE COURT: Okay, but the 1450 that's in Page 8 of
16 the deck there --

17 DR. NICULESCU: Yes.

18 THE COURT: Is the simple average, not the
19 weighted average.

20 DR. NICULESCU: Yes, correct. It is just a simple
21 average, for illustrative purposes, intended to minimize,
22 rather than increase confusion.

23 THE COURT: Okay.

24 Q Okay, so you've got these three quotes. You have no
25 other pricing information. What do you do with the three

1 quotes, in order to arrive at a value of QVT's CARB
2 position?

3 A There is a standard conversion process for credit
4 structured product of this type, for the subprime ABX index,
5 for example, also for the CARB index, which is to use a
6 concept called spread duration to convert the spread into a
7 price, or a value.

8 Q And just to be clear, you're talking only about the
9 Merrill Lynch quote, not the other two?

10 A That is correct. The other two already exist in points
11 upfront, the Merrill Lynch quote now would have to be
12 converted. The Merrill Lynch quote is the one quote that
13 Party A used, and it's the quote that I would use, because
14 Citigroup says they're indicative, so I believe I cannot use
15 it.

16 RBS says indications are good for today. I don't
17 have further information to vet the RBS quote. When it says
18 good for today, I suspect this is executable, when it says
19 indications, I now know, and am no longer confident it is
20 executable. I therefore have elected not to use the RBS
21 quote, which takes me to the same quotation that CARB Fund A
22 used, which is the Merrill Lynch quotation, but now I have
23 to convert that quotation into price.

24 Q Okay. And how do you do that?

25 A I used this concept called spread duration. Spread

1 duration is defined as the change in price for a 100 basis
2 point change in spread. And this is a standard conversion
3 that's used in the subprime ADX. Lehman itself, in its
4 introduction to CARB, references it.

5 The formula is simply the product of spread
6 duration times, the current CDS spread minus the fixed rate.
7 So if the current spread were, for example, on Caret 061D,
8 1250 basis points, I subtract 150, I then have 1100 basis
9 points, I multiply it by the spread duration, and that gives
10 me the cost of protection.

11 Q And is that method that you've described, is that a
12 standard methodology for converting spreads to prices?

13 A It is, absolutely standard.

14 MR. TAMBE: Objection, foundation, Your Honor.

15 THE COURT: Fair enough, go ahead.

16 Q Sure. Dr. Niculescu, are you familiar with the
17 methodologies that are used in the industry for converting
18 spreads to prices?

19 A Yes.

20 Q How are you familiar with that?

21 A Generally speaking, in all fixed income duration, or
22 spread duration is used, because it is definitionally, the
23 rate of change of price for a change in spread or yield.

24 And so it is a common measure that's been used in this
25 market ever since 1938 or 1939, in the market for credit

1 derivative products, such as the ABX subprime market, and
2 the CARB market, that has been defined as the conversion
3 factor, I would reference the Lehman introduction to CARB,
4 for example, which uses the spread duration. My own
5 experience in ABX, also, speaks to the use of spread
6 duration.

7 Q You mention the Lehman publication, let's take a look
8 at that. Can you pull up Defendant's Exhibit 5037, please?
9 That's in your book, it's in the back, and it's Exhibit
10 5037, if you want to turn to it. Is that the document you
11 referred to, that lies on spread duration as a methodology?

12 A Yes, it is.

13 Q And would you point us to where you're referring to?

14 A You need to go to Page 5, and to the second paragraph
15 on Page 5. Yes. What we'll see here, that the index that's
16 marked by Lehman Brothers and trades on price, rather than
17 spread terms, and is quoted as a percentage of par, so this
18 explains the otherwise confusing fact that these indexes
19 trade in bond-equivalent terms, so 97 would be a value
20 protection of \$3.

21 It goes on to say the CARB index premium is fixed
22 at 150 basis points, we've seen this before, and has a
23 spread duration of about three years, or three percent, is
24 the same concept. That that was the spread duration at the
25 time that his was written, clearly, that the duration can

1 change from time to time.

2 They then go on to explain, for example, if
3 spreads widen by 100 basis points, the CARB index would
4 trade at about 97, would trade down from par to 97. So what
5 happens is the 100 basis point move, the one percent move
6 multiplied by three is a three percent change in the current
7 value of the CARB index, or \$3 change in the value of the
8 protection purchase, the value of the protection.

9 Q So for any change in spread, if you know the spread
10 duration, you can just multiple it and come up with a change
11 in price, is that right?

12 A From par, you multiply the change from par, and you
13 apply the change in price. This works -- yes, this is the
14 standard method. And it's appropriate, and these
15 circumstances, it's relatively highly priced index
16 component.

17 Q Okay, and how do you go about determining a spread
18 duration for this CARB position?

19 A Well, we have one spread duration given to us already
20 by Lehman as a starting point. And then I looked at that,
21 and went a little further in trying to refine the spread
22 duration for this valuation purpose.

23 Q All right, why don't we take a look at Joint Exhibit
24 38, which is in the beginning of your book. Could you
25 describe what this document is, as you understand it?

1 A Yes.

2 Q And how it relates to what you're describing?

3 A Yes, this is an update on August 15th, 2008, on the
4 CARB BBB, showing Lehman's bid and offer on that index, at
5 that time. And as they do with indexes, they bid it at 79
6 and 1630 seconds, that's 79.5. They offered it at 83.5,
7 that was a change of a half a point on the day. That means
8 that they were bidding the index, 79.5, means they were
9 offering to sell protection at 100 minus 79.5, or 20.5.

10 The spread for that bid side was 882 basis points.
11 The coupon, which was also the running spread, or premium
12 for the CARB index, was 150 basis points, we see that. The
13 spread on bid side was 882, the spread on the offer side was
14 739. The coupon was 150 basis points, and they helpfully
15 show us the spread duration that they're using of 2.8. It's
16 a little bit lower than the three that they had mentioned in
17 the introduction to CARB.

18 Now, it turns out that if you take 882, and you
19 subtract from it 150 basis points, you get 732. If you
20 multiply 7.32 times 2.8, you get almost exactly 20.5, which
21 is the cost of protection. So this simply illustrates that
22 what Lehman said it was doing in its introduction is in fact
23 what it was doing in its offerings.

24 Q So is it fair to say that what you have here when you
25 have the 882 is the equivalent of the kind of quote that

1 Merrill Lynch provided, in spread terms, not price terms?

2 THE COURT: Yes, Mr. Tambe?

3 MR. TAMBE: Objection, leading, Your Honor. This
4 is complicated enough, I'd rather have the witness testify.

5 THE COURT: Well, what I'm trying to understand is
6 the methodology, that, to be entirely simplistic, gets me to
7 an apples to apples basis between the way that Merrill's
8 quoting, and the way that Citi, and RBS, and Lehman were
9 quoting.

10 MR. TRACEY: And that's exactly what I was trying
11 to draw a comparison between.

12 THE COURT: Right, so you objection on foundation
13 --

14 MR. TAMBE: No, on leading basis.

15 THE COURT: No, I understand. I'm still back at
16 the prior objection, so then we've gone through step by
17 step, and now this is just the punchline.

18 MR. TRACEY: Yeah, and I'm just really repeating
19 what the witness has already said, just to make sure that
20 it's absolutely clear on the record.

21 THE COURT: Right.

22 MR. TRACEY: It's not -- I'm not trying to lead
23 the witness anywhere, he's already taken me there.

24 THE COURT: No, I understand. So Mr. Tambe, I'm
25 not -- I mean, I hear you, it sounds leading. But it's

1 really just kind of getting the last point in what I have
2 viewed as a chain of statements.

3 MR. TAMBE: It may well be the last point, Your
4 Honor, but again, in this particular instance, maybe the
5 objection isn't sustained, but I do have a concern that as
6 we go through this -- this is complicated. There are many
7 things this witness has done that she should be explaining,
8 not shortcutting and saying, "Isn't this the same as X?"

9 THE COURT: All right, well in the spirit of
10 having some structure to it, I'm going to continue to allow
11 Mr. Tracey to ask more finely-tuned questions. You can
12 renew your objection from time to time, and I will tell you
13 that I may become more vocal that I've been during the first
14 13 days of this case, to make sure that I understand. And
15 if I raise something that you might not have -- oh well.

16 MR. TAMBE: Mm hmm, sure.

17 THE COURT: Okay?

18 MR. TAMBE: Yep.

19 THE COURT: All right. Now, can you re-ask your
20 question, please, Mr. Tracey?

21 Q Sure. I wanted to know if the spread of 882 that we
22 see on Joint Exhibit 38, is the equivalent of the -- in
23 pricing terms, of the spread that was listed by Merrill
24 Lynch, when they were offering, in spread terms, to sell
25 protection.

1 A Yes, it is. But the complication here is that the
2 Merrill Lynch spread was on each of the component parts.
3 And so as Your Honor accurately described, we needed to find
4 an accurate average of those component parts. The simple
5 average is 1450, the duration-weighted average would
6 probably be closer to 1490. So that would be the analogous
7 spread. It's on the same side of the market, it's the offer
8 to sell protection, or to buy the index. So in that sense,
9 it's analogous.

10 And it's notable that from August 15th through
11 September 15th -- September 16th, the date of the offer,
12 that spread provided by Lehman at 882 was now provided by
13 Merrill at 14 -- call it 1490. So there'd been a very
14 substantial lightening. Analogous as well, just Lehman did
15 a --

16 THE COURT: I'm sorry, but we've got that 150
17 points up front.

18 DR. NICULESCU: Correct.

19 THE COURT: So we're not in apples to apples.
20 Because the Merrill spread didn't have 150 points up front.

21 DR. NICULESCU: It does. There is a -- you can
22 buy this contract at 882, that is to say you can buy
23 protection on this at 882. You can buy protection from
24 Merrill at 1419. And the Merrill also includes the 150
25 basis points. So essentially, what you pay here is 882 for

1 Lehman, and what you're paying for Merrill is 1205. You're
2 not paying 882 plus 150, you're paying an 882 total amount,
3 and for Merrill, you're paying a 1490 total amount. They
4 are apples to apples.

5 THE COURT: Okay.

6 Q Okay. So focusing again on Joint Exhibit 38, Lehman is
7 saying you have to pay 882 spread per year for protection on
8 this.

9 A Yes.

10 Q And do I understand your testimony correctly that they
11 also provided the other kind of price, that is, the upfront
12 price?

13 A Yes.

14 Q Okay. And that was what?

15 A 20.5, that's 100 minus 79.5, 20.5.

16 Q So do I understand you correctly that here, unlike
17 Merrill Lynch, we know both types of pricing?

18 A Yes, we know both the spread and the upfront price, and
19 we see explicitly their duration assumption, which is needed
20 to go from the spread to the upfront price.

21 Q Okay, and that's 280 here?

22 A 2.80, yes.

23 Q Okay, and so we're trying to come up with a spread
24 duration that will take that 1490 number, and get to an
25 upfront price, is that correct?

1 A That's correct. Perhaps I could venture to assist the
2 Court in one other respect, if I may. If the spread shown
3 here by Lehman had been 150 basis points instead of 882,
4 then the index would have been at par, the cost of
5 protection would have been zero. And the formula would have
6 been 150 basis point spread minus 150 basis point
7 (indiscernible) equals zero, times the spread duration, the
8 cost of protection is par, is zero.

9 Q Okay. So now we've got the Merrill spreads, and we're
10 trying to come up with a spread duration, to convert it to
11 an actual price. How do you do that? You have a spread
12 duration here on Joint Exhibit 38, do you use that?

13 A No. I go out, and I don't believe I can -- I believe
14 that would overstate the value of the claim, if I used the
15 2.8 duration.

16 Q Why would that be?

17 A The reason is that as spreads widen, in this case from
18 882 to 1490, spread duration tends to get a little bit
19 shorter. This is just a matter of bond mathematics. It's
20 an analytical matter, but it's a fact, spread duration tends
21 to shorten as spreads widen slightly, and for securities of
22 this type. And so I felt it was necessary to recompute the
23 spread duration, for if I used the Lehman duration of 2.8, I
24 would have inflated or overstated the value that I believe
25 Merrill Lynch would have asked in points.

1 Q Okay, and what do you need to know in order to adjust
2 that spread duration in an appropriate way?

3 A You need to be able to project the cash flows on the
4 eight underlying securities. And in order to do that, you
5 need to have some assumption that you can put into a cash
6 flow mechanism such as Intex, in order to project how those
7 securities will pay over time. The most -- the common
8 assumption is a prepayment rate, that tells you how many
9 auto loans are going to be prepaid every year, over the
10 remaining life of the securities. Once you put that
11 assumption in, you can project the cash flows.

12 If you put that assumption in, and you put in the
13 spread of each of the components, Intex will report to you
14 the spread duration of each of those components.

15 Q Okay, and did you go through that process?

16 A Yes, yes, I did.

17 Q Okay, let's turn to your Slide 10. Could you describe
18 for the Court how you went through that process, to
19 determine that spread duration?

20 A Yes. So here we have in the orange box, the Lehman
21 spread duration, for reference. I did not use it. Instead,
22 I computed using Intex the spread duration, I did so using
23 two methods.

24 The first method was where I took the most recent
25 recorded prepayment rate, the so-called ABS rate. That was

1 reported on September 15th, it's entirely relevant. And I
2 simply assumed that that prepayment rate remained constant
3 throughout the remaining life of each one of these
4 securities. I'm of the opinion that that is a conservative
5 assumption. As prepayment rates decline, the average lives
6 extend. The security becomes longer. As it becomes longer,
7 the spread duration goes up.

8 Now, prepayments had been slowing considerably in
9 the few months up to this point. And slowing despite the
10 fact that seasonally, they would tend to increase at that
11 time. Prepayments and auto loans tends to track how
12 frequently people trade in their cars. When you trade in
13 your car, you trade off your auto loan, and get a new loan.
14 So in worse economic environments, people tend to trade in
15 their cars less frequently, and prepayments tend to go down.

16 I think that it could be that the right prepayment
17 projection that a dealer might have made at a time would be
18 appropriate payments to continue to decline. I think I
19 remember reading Mr. McDougall, in testimony suggesting
20 that. I would agree with that. I don't have any particular
21 factual basis to project a decline at that point, and so
22 instead, I just decided to leave that prepayment projection
23 constant.

24 If I do that, and I input each one of the spreads
25 for each one of the eight component parts, I compute a

1 spread duration -- Intex computes for me a spread duration
2 of 2.6, a little bit less than Lehman's 2.8. That's my
3 first method.

4 Q Okay. And you used two methods, why did you use two
5 methods?

6 THE COURT: Can I stop you before you move on,
7 (indiscernible)?

8 MR. TRACEY: Sure.

9 THE COURT: You're talking about prepayment rates.

10 DR. NICULESCU: Yes.

11 THE COURT: So you're talking about not Joe
12 Consumer makes his car payment every month. You're taking
13 about Joe Consume has five car payments left, and prepays
14 the rest of those payments.

15 DR. NICULESCU: Yes. Joe Consumer decided to sell
16 his Pontiac and buy Buick, and when he did that, he had to
17 pay off the Pontiac loan, which had five months left on it,
18 and get a new loan for the Buick.

19 THE COURT: And you're saying that the decline in
20 the rate of prepayment is a driver of the pricing of
21 protection on CARB?

22 DR. NICULESCU: It is. It's a driver of how long
23 you can project these securities to stay outstanding. And
24 these securities all extended --

25 THE COURT: The securities that are in the CARB

1 basket, or the securities being the actual auto loans that
2 Joe Consumer is paying off?

3 DR. NICULESCU: The securities being the
4 securities referenced by the CDS in the CARB basket, which
5 are these subordinate tranches of deals that are backed by
6 the loans that Joe Consumer has.

7 THE COURT: Okay.

8 DR. NICULESCU: And as Joe Consumer pays that more
9 slowly, these particular tranches tend to extend, they get
10 longer, and as their average lives get longer, somebody
11 looking to sell protection on them will find that protection
12 exposes them to risk for a longer period of time.

13 Q And so am I correct that the slower the prepayments,
14 the higher the spread duration?

15 A Yes.

16 Q And so you need it to figure out the level of
17 prepayments to get to your spread duration?

18 A That is correct, yes.

19 Q So in method one, you said you used the most recent
20 prepayment numbers, correct?

21 A That's correct.

22 Q Did you use a different method in method two to predict
23 those prepayments?

24 A Oh yes, yes. So on method two, I went back to the
25 sheet, the offering sheet that Merrill had provided to fund

1 Counterparty A, and I observed that there are what appear to
2 be weight average lives written on that sheet for each one
3 of those components.

4 Q All right, let's just go back to that and make sure
5 that we are together. That's back in Joint Exhibit 73? And
6 are you talking about the weighted average lives in the
7 Merrill Lynch quote in Joint Exhibit 73?

8 A I am.

9 Q And show us where those are?

10 A Can you go to the page that shows the Merrill Lynch
11 offering, please?

12 Q It's 1808.

13 A Here we are, yes. So you'll see that what Merrill
14 Lynch has done is populated each of the eight lines from
15 caret 061B through (indiscernible) 7AC, shown the rating,
16 shown the weighted average life, and shown the spread or
17 premium that they would require.

18 And so here we have a series of weighted average
19 lives, starting at 8.18 years, caret 061D, which is a very
20 short, very subordinate piece, but it's a very short piece,
21 out to one of the most recently-issued pieces, caret 072,
22 3.56 years. So my intention here was by trial and error to
23 put in prepayment rates into Intex, until the weighted
24 average life of the underlying security matched this
25 weighted average life. And so that's what I've done, I've

1 matched those weighted average lives by iterating on the
2 prepayment rate.

3 Q Okay. And so when you performed that, what spread
4 duration do you get?

5 A I get a spread duration of 2.3, instead of 2.6. It's a
6 shorter spread duration. These weighted average lives
7 appear to be consistent with somewhat faster prepayments,
8 and the prepayment rate that was reported most recently on
9 September 15th, 2008. I'll note, however, that there is
10 something else on the Merrill Lynch sheet that is in
11 conflict with --

12 Q Before we get to a conflict, I want to make sure we
13 understand where we are now.

14 A Certainly.

15 Q So we started with a Lehman spread duration number of
16 2.8, remember.

17 A Yes.

18 Q And you adjusted under your first method to 2.6, is
19 that right?

20 A Yes, yes.

21 Q And as a result of that adjustment, does the value of
22 the protection go up or down?

23 A The value of the protection goes down. And I'll tell
24 you by exactly how much, it goes down by 0.2 over 2.8. It
25 goes down by a little bit less than 10 percent.

1 Q Okay. And do I follow you that when you do your second
2 method, and adjust it again, the price goes down again.

3 A Correct, yes, so it goes down in this case from what it
4 would have been by 0.5 of 2.8, so it goes down by that,
5 slightly less than 20 percent. 0.5 over 2.8.

6 Q So under either of your scenarios, the price of
7 protection is lower than using Lehman spread duration?

8 A Yes, that's correct.

9 Q All right, so now we've got those two spread durations,
10 and we can move forward, but you wanted to talk about a
11 conflict.

12 A Yes, if you go back to the Exhibit 1808, you'll see
13 that there is written on the page 7CPR, a couple of lines
14 above. I am of the opinion that likely refers to a
15 prepayment projection used for valuation, but I don't have
16 any other basis to support that conclusion. I see it on the
17 page, but I haven't been able to vet it in any other way.
18 If I were to use a 7CPR, the spread duration would in fact,
19 be considered to be higher than this. I have not done that.
20 I know it's on the page, but I have no further information
21 that allows me to use it in one way or another.

22 Q Would the spread duration, if you used 7CPR, would be
23 higher than either of your two methods?

24 A Correct.

25 Q And that would be a higher value and a higher cost?

1 A Correct.

2 Q But you haven't used it.

3 A I haven't used it, I have no other basis to presume its
4 use.

5 Q Okay. So now we've got the 2.3 and 2.6 spread
6 durations, how do you turn those into prices?

7 A So those spread durations then must be multiplied -- in
8 fact, the spread duration for each of the eight component
9 parts has been multiplied by the spread for each of the
10 eight component parts, the spread that Merrill Lynch quoted,
11 then summed up, and the results I show on the next slide,
12 where I've now converted the Merrill Lynch quote using
13 method one and method two using price terms, this is percent
14 of notional. Method one, with the longer duration, has the
15 higher value, it's 34.8 percent. Method two is 31.6
16 percent. This is for \$15 million size, and it compares to
17 Lehman's offer, on August 21st, of 23 percent, for what is
18 commonly, as Mr. McDougall said, a \$5 million to \$10 million
19 market.

20 Q And so to get to an actual dollar number, how would you
21 take your percentage numbers and get to a dollar number for
22 2000?

23 A The problem I face is that \$18 is a very different
24 amount than \$15. And if Merrill Lynch were prepared to ask
25 to be paid between 31 and 35 percent of 15 million, I am of

1 the opinion they would have wanted considerably more money
2 in order to sell protection on \$80 million. So my task
3 really now is to bale up a reasonable adjustment for the
4 much larger size of the QVT position, that's my next task.

5 Q And how do you know about --

6 MR. TAMBE: I'll just note my objection to foundation to
7 part of that answer. I understand the calculation he's
8 done, I have the objection to foundation.

9 THE COURT: It's an assumption, correct? It's an
10 assumption, it's not based on any empirical --

11 DR. NICULESCU: The size adjustment?

12 THE COURT: Yes.

13 DR. NICULESCU: The size adjustment is based on
14 empirical data.

15 MR. TRACEY: We're going to take the Court through
16 that.

17 THE COURT: Okay.

18 Q Okay, what did you base your size adjustment on?

19 A I observed a trade, a transaction that Lehman had done
20 with QVT on July 17th, 2008.

21 Q Okay, let's take a look at that. John, could you bring
22 up Lehman's Exhibit 1173? Okay, so before we get into this,
23 just, could you tell us why we're looking at these
24 documents, and what they have to do with a size adjustment?

25 A Certainly. What we'll see is that Lehman did a \$10

1 million trade with QVT on July 17th, and minutes after they
2 did the trade, they sent out an email broadly updating the
3 market, saying that trading in CARB leads the market at a
4 new level. So that \$10 million trade, Lehman said a few
5 minutes later, caused them to move their price on
6 protection. In fact, a \$10 million trade caused them to
7 lower their price of protection by a point and a half in
8 July of 2008.

9 THE COURT: I'm sorry, I totally missed, where is
10 that?

11 MR. TRACEY: We're going to take the Court through
12 it. That's just the -- that's the introduction.

13 THE COURT: That was the preview? I see. Okay.

14 MR. TRACEY: All right, so let's --

15 THE COURT: Sorry, I don't mean to be impatient.

16 MR. TRACEY: No, no, we're getting to it quickly.

17 DR. NICULESCU: It's exciting stuff.

18 Q Okay, so Dr. Niculescu, if you could look at Claimant's
19 Exhibit 1173, and tell us what you see there.

20 A Yes, so this is an email sent by John (indiscernible)
21 on Thursday, July 17th at 9:12 AM. It's a CARB auto-update.
22 It shows their bids and offerings on their three CARB
23 indexes. Only the last one, the 071 BBB is relevant, and
24 ever traded. You see, we're now familiar with these things,
25 at this point, that the spread duration at this time was

1 3.0.

2 Now, I will look to the offered side of
3 protection, as that's what relevant here today, which was 84
4 points. That was where they would offer the index where
5 Lehman would be prepared to buy protection. That's a spread
6 of 683 basis points. They would buy protection at 100
7 minutes 84, that is, they would pay 16 points.

8 Q Okay, so that's an offer.

9 A I will note that they -- they also note spreads assumed
10 most stressed are underlying cash flows. This is just, they
11 just project cash flows, no defaults -- I beg your pardon.
12 Spreads assume most stress to underlying cash flows. They
13 simply project these cash flows, with no presumption of nay
14 defaults being embedded in the project.

15 Q And so do I understand you that 1173 is an offer by
16 Lehman? Or a quotation?

17 A I'm sorry, 1173?

18 Q Yes, Claimant's Exhibit 1173 (indiscernible) --

19 A Oh, I beg your pardon. Claimant's Exhibit, yes, this
20 is a bid and offer for protection by Lehman, it's a two-way
21 market.

22 Q Okay. Now turn, if you would, to Claimant's Exhibit
23 1174, and tell me what that represents.

24 A This is a trade confirmation from somebody,
25 (indiscernible), it would be (indiscernible) at Lehman to

1 Arthur Chu and others, please confirm the following trade:

2 Lehman sells 10 million CARB 071 BBB to QVT at 84.

3 Then clarification, Lehman is selling the
4 index/buying protection on this trade. So Lehman is buying
5 protection from QVT for 10 million. Lehman pays just under
6 1.6 million, that's a 16 points, based on the accrual start
7 date, at 150 basis point running spread. So they're paying
8 effectively the 16 points on a \$10 million transaction.

9 Q Okay. So that's the trade. And then if you would turn
10 to Claimant's Exhibit 1175, and tell me what that
11 represents.

12 A Yes, now note the date, the time. It's the same date,
13 July 17th, at 9:20 AM. You'll note that the previous email
14 that updated the CARB level was at 9:12 AM, so this is some
15 eight minutes later. And the subject says CARB auto-
16 updated, trading BBBs, LVS, this means leaves, trading BBBs
17 leaves 82.5, 85.5. And as you look at the change, you'll
18 see that the change for the 071 BBB, in the body, is 1.5
19 points.

20 So what happened here is we had one update at
21 9:12, we had a trade with QVT for 10 million, Lehman comes
22 out shortly afterwards with an update that as a result of
23 trading in BBBs, we know this is a \$10 million, the market
24 has moved by a point and a half, so QVT could no longer sell
25 protection to Lehman at 16 points, it could only sell

1 protection to Lehman at 14.5 points. In other words, that
2 \$10 million trade was enough to move the market by 1.5
3 points.

4 Q And just to be clear, what is leaves 82.16, 85.16 in
5 the subject mean?

6 A It means that that is the new market level, that
7 reading has caused the market to move to that level. It now
8 leaves the market at 82.5, 85.5.

9 Q Okay. And what is the significance of that 1.5 point
10 move on a \$10 million trade, to your analysis?

11 A The significance was to me is that this was indeed a
12 market that was very thin, even in July, and even with the
13 sponsoring party, Lehman, that sponsored the index, a
14 relatively small trade of 10 million would cause Lehman to
15 move the price of the index at that time by 1.5 points,
16 presumably in order to encourage somebody else to buy
17 protection, and discourage people from selling protection.
18 So they had (indiscernible) little appetite for this risk,
19 and as somebody came in and sold them 10 million protection,
20 they didn't want to buy any more protection, so they moved
21 the market in order to encourage people to buy protection,
22 and discourage others form selling protection.

23 MR. TAMBE: Objection, move to strike, lack of
24 foundation, speculation.

25 THE COURT: Okay, so I need to go back. So the

1 first thing that you looked at with Mr. Tracey was Exhibit
2 1173, right? (indiscernible) Thursday, 9:12, right?

3 DR. NICULESCU: Yes.

4 THE COURT: And then eight minutes later is
5 Exhibit 1175, right?

6 DR. NICULESCU: Yes.

7 THE COURT: And you're saying in those eight
8 minutes, a trade occurred that moved the market?

9 DR. NICULESCU: That's right.

10 THE COURT: And how do you know that?

11 DR. NICULESCU: Because Lehman says that there was
12 an update of trading eight minutes after the first run, they
13 say update trade in BBBs leaves 82.5, 85.5. That's what
14 they're saying in the second email.

15 THE COURT: Okay. And how do you know what
16 trading they're referring to?

17 DR. NICULESCU: We've seen the Lehman trade log,
18 and there was one trade, there was that 10 million trade,
19 and so that was the trade that (indiscernible).

20 THE COURT: The \$10 million trade that's at 1174?

21 MR. TRACEY: Yes.

22 DR. NICULESCU: The trade was reported at -- yeah,
23 we see it at what is it, Claimant's 1174? Yes, that's
24 right, that's the trade that was on that date.

25 THE COURT: And there's some other document that

1 shows when that trade occurred?

2 DR. NICULESCU: No, not to my knowledge. The
3 trade confirm went out at 2:57 PM, but the only trade in the
4 Lehman trade log that day was this trade.

5 MR. TAMBE: I still have my objection to
6 foundation, form, and speculation. I just don't think
7 there's any basis for the testimony.

8 THE COURT: Could you come up for a moment,
9 please? We're going to take a nine-minute break, you're
10 welcome to stay here or take a walk.

11 (Recess)

12 THE COURT: Have a seat. Thank you for your
13 patience.

14 DR. NICULESCU: You're welcome.

15 THE COURT: Okay, Mr. Tracey.

16 MR. TRACEY: Okay. Thank you, your honor.

17 THE COURT: When we last -- when we left off, I
18 was asking Dr. Niculescu about the trade that had moved the
19 CARB pricing.

20 Q And Dr. Niculescu, you were asked some questions by the
21 Court about how you know that the trade that is referred to
22 in these documents was the one that moved the market? And
23 could you describe how you know that?

24 A Yes. This is something of detective work, indeed.

25 There was one trade reported that day on the Lehman trade

1 log, for \$10 million. That trade was the trade with QVT.

2 It's reported in the confirm here. Confirms typically go

3 out somewhat later in the day that the trade happens.

4 They're executed by the back office. It says confirm went

5 out around 3:00 PM that day.

6 But the trade, Lehman reported as of 9:20 that

7 there was a trade in its email, and that it led the market

8 to 1.5 lower, in terms of protection, than it had been

9 previously. And so putting these pieces together, there was

10 that one trade on that day. It was reported by Lehman at

11 9:20 in the morning, therefore that has to have been the

12 trade that moved the market by that amount.

13 Q Okay. I'd like to bring up that log, and show it to

14 you, if I may?

15 A Yes.

16 Q That's Claimant's Exhibit 2078. Okay, and placed

17 before you, what's been previously marked as Claimant's

18 Exhibit 2078, can you identify that document?

19 A This looks like the Lehman trade log for CARB.

20 Q Okay. Can you scroll to the right, John? Now, what

21 I'd like to do -- is it your understanding that this

22 reflects all of the trades for CARB?

23 A Yes.

24 Q And now we've filtered this to reflect only the trades

25 that took place on July 17th, 2008. (indiscernible) in

1 Column P. Do you see what's left on the CARB log?

2 A Yes.

3 Q And does that -- what does that reflect?

4 A This reflects one trade, was allocated across two
5 parties, QVT fund and QVT financial Quintessence. The total
6 amount is the sum of the two notionals in Column F. And if
7 you sum that, I believe it sums to 10 million, that has a
8 maturity date of 2014, it shows the upfront fee, which sums
9 to the number shown, I believe, on the trade confer. And
10 the other details are as you would have expected.

11 Q And do you conclude -- what do you conclude from this?

12 A Well, I conclude from the Lehman trade log, which I
13 take to be accurate, that Lehman did one trade on July 17th,
14 2008. That was the trade with QVT. It is the trade that is
15 described in the Lehman email that confirms that trade. The
16 conditions and terms match precisely. And it has to have
17 been the trade that was executed immediately prior to 9:20
18 AM, because of Lehman's email saying that trading in CARB
19 BBBs leaves the market at 85.5, at a new level. I think
20 there can be no doubt this is the trade that's being
21 referred to, and this was the consequence of that trade.

22 Q Okay, and so you've stated that that trade moved the
23 market 1.5 points. How do you use that to determine a size
24 adjustment for the size of QVT's trade?

25 A The size of QVT's trade was \$80 million, which was 65

1 million more than the size quoted by Merrill Lynch to fund
2 Party A. I can see that a \$10 million trade back in July
3 moved the market by 1.5. I therefore make an assumption.
4 My assumption is that the market sensitivity in September,
5 without Lehman being present, was the same as the market
6 sensitivity in July, when Lehman was present. And I can
7 simply take the new larger size, incremental size, and
8 multiply it by the size adjustment for \$10 million.

9 So what I do is I take 65 million, which is 6.5
10 times 10 million, and then multiply it by 1.5 points. The
11 result of multiplying 6.5 by 1.5 is 9.75, so I proposed
12 adjusting the price by 9.75 points. Now, I would seek to
13 explain that, if you will --

14 Q Please explain how you come to that conclusion.

15 A There's a number of assumptions here. First, what I'm
16 doing is I'm trying to move up a demand curve by saying that
17 if a certain price, let's say 34, was good for 15 million,
18 what would the price have to be to be good for something
19 that's 65 points, \$65 million larger? How much more would I
20 have to pay to move it up that amount? And I observed there
21 was a price sensitivity back in July, 1.5 per 10 million, so
22 I'm applying that sensitivity.

23 Now, there's two possible flaws I see with this
24 approach. On the positive size, the approach is strictly
25 data-driven. Whenever possible, I like to find data to

1 support my results, rather than simply depending on my
2 experience, or others. And this is purely data-drive. I
3 have a data observation, I know the size of the trade, I
4 know the sensitivity of the impact of the trade, so it's
5 data-driven. The flaws, however, one's a positive flaw,
6 one's a negative flaw.

7 On the positive size, in September of 2008, the
8 sponsor to CARB, Lehman, had gone out of business. Anybody
9 else looking to step in had less vested interest in
10 maintaining the product, had little idea of where they could
11 go with the product, where they could resell it, might have
12 had to take a significant risk position. And the market was
13 substantially liquid, and more volatile than it had been in
14 July. People were less willing, in my experience, to take
15 on new risk positions in September than they had been in
16 July.

17 Furthermore, even Lehman, between July and August,
18 had widened its own bid-ask spread on CARB from three points
19 to four points, indicating that it, itself was less inclined
20 to take on new CARB positions, even in August, than it had
21 been in July. Collectively, these points would suggest that
22 the size adjustment may not be big enough. Perhaps instead
23 of 9.75 points, it should be 10 or 15 points. I don't have
24 data, specific data that allows me to calculate what that
25 number would be, but I can't say that a larger size

1 adjustment would be unreasonable, either. Therefore, I'm
2 not offering it, but I couldn't rule out the reasonableness
3 of a larger-size adjustment.

4 On the other side of the ledger, it's not always
5 the case that a market impact of the type I've described
6 here, the 1.5 points, just continues ad infinitum, for every
7 \$10 million. It may not be the case that a full 9.75 points
8 would actually have been necessary on September 15th, 2008.
9 And my experience, once the price goes up enough, maybe you
10 find other people coming into the market anyway,
11 irrespective of what the first entail sensitivity was to
12 size.

13 And my experience in consulting with my team that
14 have experience also in credit derivative products, we
15 concluded that it might be reasonable, based on our
16 experience, that a 200 basis point spread concession might
17 have been enough to encourage other entrants into the market
18 at this time, in order to handle this much larger size
19 position. So if Merrill Lynch had quoted a spread that on a
20 duration-adjusted basis, was approximately 492 basis points,
21 perhaps a spread of 1692 basis points would have been enough
22 to clear the full \$80 million size.

23 And so I offer those two possible, excuse me,
24 those two possible methods to compute the size adjustment.
25 The first one is the 9.75 point method. The second one is

1 the 200 basis point incremental yield spread method, which
2 is based on my own experience and my team's experience.

3 Q How do those two methods change the value?

4 A Well, so if I use the 9.75 point scenario, all I'm
5 doing is adding 9.75 points to the previous price that
6 you've seen there, which rounds to between 41.3 and 44.6
7 percent of the \$18 million of the notional. If I do the 200
8 basis point scenario on the following page, the numbers vary
9 between 36 percent, and 39.8 percent. And you see
10 underneath it, on my Page 14, what that translates into as
11 dollars, for replacement cost of the \$18 million notional
12 position.

13 Q And so having reached those conclusions, first of all,
14 do you have any views as to which of the methods is more
15 valid? Or do you rely equally on the two?

16 A I am inclined toward method one, in place of method
17 two. Method two, as you may remember, used the weighted
18 average lives on a sheet that Merrill Lynch had provided.
19 In my opinion, those weighted average lives most likely came
20 off a descriptive database, along with the ratings, and were
21 a previously-calculated weighted average life, and were
22 likely not updated.

23 If Merrill Lynch had proposed to use them, in its
24 conversion, I strongly suspect they would have done the
25 conversion themselves and shown the points upfront, instead

1 of showing the spread. But they did not show the points
2 upfront. In fact, elsewhere on the email chain, they show a
3 second at 7CPR, which could have been another prepayment
4 assumption. I therefore tend to discount method two, the
5 weighted average life method, as less likely as a prepayment
6 projection method used in method one.

7 THE COURT: Mr. Tambe.

8 MR. TAMBE: Objection, lack of foundation,
9 speculation, to the extent that prior answer was speculating
10 about what Merrill had or had not done.

11 MR. TRACEY: If I may, Your Honor, I don't think
12 the witness was speculating about what Merrill did or did
13 not do. He's basing his price on an assumption about what
14 he believes Merrill was pricing this at, his assumption, and
15 he's making clear his assumptions, and obviously Lehman can
16 cross-examine on those assumption.

17 THE COURT: It's an assumption, then.

18 MR. TRACEY: It's an assumption.

19 THE COURT: Fair enough, okay.

20 MR. TRACEY: Okay. I'd like to go back for a
21 movement --

22 THE COURT: So just to tie it up, so this slide,
23 which is on Page 14 of the deck, this provides the range
24 that you showed initially on Page 3 of the deck, yes? 29, a
25 range of 29 to 36?

1 DR. NICULESCU: That is correct, yes.

2 THE COURT: Taking the lowest in the 200 basis
3 point scenario, and the higher in the -- the lower in the
4 200 basis point scenario, and the higher at the 9.75.

5 DR. NICULESCU: That is correct, yes.

6 THE COURT: Thank you.

7 Q Okay, I'd like to go back, just to two points that we
8 touched on, but didn't talk about. If you could open up
9 again to Joint Exhibit 73, and the quotes are on the second,
10 third, and fourth page, we've been through those, but I'd
11 like to focus for a moment on the first page.

12 A Yes.

13 Q And once again, could you just describe what you
14 believe this page represents, in broad terms?

15 A Yes, this is a summary, provided by Fund Party A to
16 Lehman, of their market quotation process, listing the index
17 equivalent prices they received from Citi and RBS, and also
18 showing a price that they calculated, shown as calculate
19 price, based on the Merrill Lynch spread quotes, for each of
20 the eight components of the CARB index.

21 Q And so do you understand that to be that that party
22 converted the spreads in the Merrill Lynch quote to prices?

23 A Yes.

24 Q And why didn't you use those prices?

25 A Because they're wrong.

1 Q And how are they wrong?

2 A Well, I examined the prices carefully, based on the
3 data provided to me by Lehman from Fund Party A. They made
4 a host of mistakes, the most prominent one of which is they
5 simply took the spread, and they put it into a bond price
6 calculator, instead of computing the points upfront value of
7 the CDS. And the bond has a different coupon, it has a
8 different price. You simply can't do that calculation that
9 way. They make a number of other mistakes in their use of
10 that calculator as well.

11 But the bottom line is the calculation is simply
12 incorrect. And I can't sign off on something that is
13 incorrect, particularly when the methodology to convert from
14 spread to prices is well-known, it's well-accepted. Lehman
15 mentioned in its introduction, Lehman uses it, you can
16 simply use the same methodology, and it's simple to do.

17 Q The other question I would have for you is if you look
18 at the quotations that were used for your calculation, they
19 date dated September 16, 2008, is that correct?

20 A That's correct.

21 Q And you know that the early termination date in this
22 case is September 15th, correct?

23 A Yes.

24 Q Did you consider whether that would affect your
25 analysis of these prices, as applied to a case in which the

1 price must be determined as of September 15th?

2 A Yes, I did consider it. I concluded there is should be
3 no effect. I saw no basis, based on any data, to presume
4 that the price would have changed between the 15th and the
5 16th, and in particular, as a request on the morning of the
6 16th. And indeed, for an index that is this illiquid, it
7 trades by appointment, I saw no basis to make an adjustment.

8 Q Did you do anything to assess the reasonableness of the
9 result that you reached?

10 A Yes, yes, I did. Quite a few things. But really the
11 first point, I think, to make, is that we are looking at a
12 change in spread from 882 basis points offered by Lehman for
13 5 to 10 million back in August, August 15th. So 1492 basis
14 points offered by Merrill Lynch in September 16th. So it
15 was a substantial change. And so I looked to see whether
16 that change would, in fact, be reasonable. And really, the
17 first and most overarching issue is that it is Lehman's
18 bankruptcy. Lehman was the sponsor of the CARB product,
19 they had a vested interest in maintaining its trading.
20 Merrill Lynch did not, and presumably would have had to take
21 on that risk position themselves. People were disinclined
22 to take on risk positions. And so I'm not surprised to see
23 some spreads, actionable spreads at much wider levels than
24 the ones that Lehman had proposed.

25 But in addition, I wanted to examine the other

1 factors that drive, or cause spreads to change, and
2 performers to change, and so I did that, and went to look
3 for market commentary in the sector at the time, and found
4 fairly extensive market commentary relating to consumer ABS.
5 I should mention at this point that the consumer ABS sector
6 is quite distinct from the mortgage MBS sector, developments
7 that affect mortgage-backed securities do not always affect
8 consumer ABS and vice versa. And in fact, the worst and
9 positive developments for MBS in August that did not affect
10 consumer ABS.

11 But I uncovered a number of research commentaries,
12 trading commentaries contemporaneous with these events. The
13 first one I show here is dated September 5th, from JP
14 Morgan. As of September 5th, they say AAA consumer ABS
15 spreads had reached record widths, high spreads, reflecting
16 mainly thin demand, and increased center servicer headlines.

17 Q Dr. Niculescu, could you just be a little slower?

18 A Certainly. You need me to repeat this?

19 THE COURT: Can I help you in that regard, and ask
20 the question of when you on this slide, and it looks like
21 you're quoting a JP Morgan speculation, are referring to
22 consumer ABS?

23 DR. NICULESCU: Yes.

24 THE COURT: What comprises consumer ABS?

25 DR. NICULESCU: It comprises, as Mr. McDougall

1 said this morning, primarily credit card receivables, auto
2 receivables, some people classify student loans as part of
3 consumer ABS.

4 THE COURT: So when this -- when JP Morgan's
5 talking about consumer ABS, it's talking about not just auto
6 ABS?

7 DR. NICULESCU: No, they are also including credit
8 card receivables.

9 THE COURT: Thank you.

10 DR. NICULESCU: However, the consumer ABS sector
11 tends to be traded in one place, and tends to be distinct
12 from the MBS sector. For example, at Goldman Sachs, I had
13 MBS research, and separately I had ABS research that spans
14 all of those sectors.

15 THE COURT: Got it, thank you.

16 A The rest of the JP Morgan quote I think points to some
17 of the fundamental deteriorations that could affect consumer
18 ABS sharp weakening on the employment picture, for example.
19 There was another quote here, Credit Suisse, in their
20 explicitly non-mortgage ABS commentary on September 17th,
21 saying the bold, the only thing that is certain is the
22 spreads have gap out, and bid-asks have widened, as the few
23 dealers lefts aren't really sure where they will be able to
24 retail, that is to sell paper. By the end of the month,
25 September 30, Barclay's noted consumer ABS at all-time wades

1 in September. So we have clear statement by the dealer
2 community here that consumer ABS spreads had widened into
3 and through September, supporting that whatever level Lehman
4 had provided in August of 882, even if Lehman had still been
5 around, would likely have been a considerably wider level by
6 mid-September.

7 Next, we go to the underlying fundamentals. The
8 underlying fundamentals were worsening. It was possible
9 that the economy was going into a significant recession. On
10 September 5th, Deutsche Bank noted that the spike in
11 unemployment, the highest level in five years, should put an
12 additional level of pressure on consumer ABS products.
13 Again, the reasoning here is as those unemployment pictures
14 worsen, people will start to default on their consumer
15 loans. UBS, excuse me, my old friends here, made that clear
16 on September 16th. The consumer ABS market's already
17 experiencing the rising tide of delinquency that accompany
18 economic downturn and go on to speculate about possible
19 future events.

20 In addition to the fundamental economic market,
21 there was specific servicer risk relating to auto ABS that
22 people mentioned. If you go back to Lehman's introduction
23 to CARB in 2007, they make a point of noting that in the
24 event of a servicing transfer due to bankruptcy, you're
25 likely to see a disruption, due to lack of experience and

1 operational issues. The lack of comfort in the continuing
2 operation of the major auto dealers could certainly have
3 been a factor, and the need of one of the dealers had the
4 fact, if you expected the bankruptcy that ultimately
5 occurred, if you expected that in September, you might well
6 have seen that the values of the vehicles would have gone
7 down, the recovery values of that vehicle collateral would
8 have been impaired.

9 A new servicer might not have been as effective,
10 and a new servicer might well have asked for more money to
11 do the job. The only money available to the servicer comes
12 from the trust structure, and it comes therefore out of
13 credit support payments, that might otherwise ensure the
14 performance of the subordinate tranches (indiscernible). You
15 update that to September 5th, and JP Morgan is saying the
16 seller servicer risks simply overshadow everything else on
17 auto ABS. So now we have another factor that would explain
18 the spread widening between August and mid-September.

19 With this as a backdrop, I then turn to the actual
20 credit of the underlying assets that are referenced by the
21 CARB. I show on my Slide 20 an example, this is caret 071,
22 shown as of September 15th, 2008. (indiscernible) 73,000
23 auto loans left, a good amount of them paid off already,
24 amortized away, or in some cases, prepaid. And if you look
25 at the notes on the right, 44 percent of the original issued

1 notes have also been paid off, those were the A1s and part
2 of the A2s, the most senior and shortest cash flows.

3 As payments come in, either amortizing or
4 prepayment, the senior and early cash flows get paid off
5 first. As losses come in, of course, they come in from the
6 bottom of the structure. In 071s, we are interested in
7 Class C, that's our reference entity. It's 1.5 percent of
8 the original size of the deal. There's about a half of
9 percent of Class Ds underneath it, and some residual
10 payments that were going at that time to the depositor. So
11 this is the structure that we're looking at here.

12 With that in mind, I think it's worth looking at
13 the underlying credit of the CARB loans, on Page 21. I'll
14 point you to caret 020071, this was the deal of which
15 Tranche C is the second-to-the-lowest subordinate tranche.
16 We'll note that although these are called prime deals,
17 because the average credit score the average FICO is a prime
18 FICO, they're mixed. They had some very good-quality loans,
19 and some very low-credit-quality loans in the same deal.
20 Some regulators would say that a FICO of less than 660 is
21 subprime. The FICO is reported at lower than 650 for the
22 20071s, that was 26.8 percent at origination, so about a
23 quarter of the deal.

24 Part of this deal is already paid off, and it's
25 likely that the highest quality part of the deal has already

1 paid off, leaving a larger proportion of subprime loans, a
2 very significant volume of loans that have more than 110
3 percent of loan to value ratio, the concentration in the
4 stakes that people were most concerned about at the time.

5 Almost 10 percent of the deal has interest rates
6 greater than 10 percent. Well, this is very curious,
7 because a lot of loans in this deal have relatively low
8 interest rates. The automakers were incentivizing for
9 people to buy cars by providing submarket financing rates of
10 two percent, and such like. But here we have a tail in the
11 deal that has a very high set of interest rates.

12 So collectively, we have a large part of this
13 deal, a quarter to a third of the original balance that was
14 comprised of credit-quality loans that were, I think,
15 considered at the time to be of concern to people who
16 specialized in the credit.

17 And it's important, I think, at that point, to
18 really examine the risk and return framework that people
19 would have adopted, in looking at assets of this type that I
20 adopted, and looking at ABS, when I was buying the Fannie
21 Mae, to try to weight the risks and returns that you face
22 here. It is not the case, necessarily, that these
23 subordinate tranches were necessarily going to suffer credit
24 losses, far from. There was a chance that they might. It
25 wasn't an 80 percent chance, it wasn't even a 50 percent

1 chance. But the premiums that people were asking also
2 reflected a much lower probability of taking losses to these
3 tranches.

4 So Merrill Lynch quoting 1492 basis points,
5 they're essentially saying they want to be paid 14.9 percent
6 per year to guarantee this performance. Well, in theory,
7 that would translate into about a one in seven probability
8 of losing your investment every year. Now, clearly, Merrill
9 Lynch likely thought that losing their investment was less
10 than one in seven, or they wouldn't have offered that
11 spread. They wanted some compensation for taking the risk.
12 Did they think it was -- would a reasonable investor, not
13 Merrill Lynch, would I at the time thought the change was
14 one in 10, or one in 12, or one in 15? Possibly, something
15 in that order of magnitude.

16 And when I look at the sort of, of size of the
17 subprime components here, of the high loan to value
18 components, and I contrast that with the credit support
19 available to my tranche. I could say, "Yes, it might well
20 be reasonable that I would presume that there was a one in
21 10, or one in 12, or one in 15 chance of my tranche being
22 hit significantly with credit losses, and therefore that
23 that spread makes some sense to me.

24 MR. TAMBE: So, if I could interject, I object to
25 this point, to the narrative nature of that answer, and all

1 the instances therein where he was just speculating and
2 saying -- making statements without foundation. So I just
3 want to preserve the objection.

4 THE COURT: All right, fair enough.

5 MR. TRACEY: I'm just about finished with CARB.

6 THE COURT: Can I just ask one follow-up question?

7 MR. TRACEY: Sure.

8 THE COURT: So what you're suggesting is that the
9 pricing may reflect a bit of a disconnect with a more
10 granular analysis of the underlying potential performance of
11 the loans that are in the trusts?

12 DR. NICULESCU: Your Honor, no, I wouldn't suggest
13 that. I would suggest --

14 THE COURT: You were just talking about a one in
15 seven chance of there being a default, or a one in ten
16 chance.

17 DR. NICULESCU: Correct.

18 THE COURT: And that nonetheless, the pricing to
19 sell protection was what it is. I thought you were
20 suggesting that there wasn't necessarily a connection, if
21 somebody had peeled back all the layers, and looked at the
22 chance that in fact, there would be a default in payment on
23 the underlying loans? Was that not what you were saying?

24 DR. NICULESCU: I was trying to say the opposite,
25 I apologize.

1 THE COURT: Okay.

2 DR. NICULESCU: My attempt was to say that the
3 pricing was consistent with a one in --

4 THE COURT: Pricing of the protection --

5 DR. NICULESCU: Price of protection.

6 THE COURT: Yes.

7 DR. NICULESCU: Consistent with a one in seven
8 chance, annually. In the fixed income markets, people
9 demand and receive a risk premium for taking risks. In this
10 case, the risk of selling protection. If I, as an investor,
11 had truly believed there was a one in seven chance each year
12 that my investment would be wiped out, I would want a lot
13 more than 14 percent return to take that risk. So if I'm
14 getting 14 percent return, what therefore must be my
15 projected expectation of loss? Something lower than one in
16 seven. Could it be one in 10, one in 12, one in 15?
17 Possibly in that range.

18 THE COURT: Thank you.

19 DR. NICULESCU: If I look at these
20 characteristics, these to me are consistent with a one in
21 10, one in 15 chance of loss each year.

22 THE COURT: Thank you.

23 Q Okay. I'd like to take you back to the bottom line
24 values that you came to, and ask you to remind us of what
25 the value is that you came to, and how it compares to other

1 values that you have observed.

2 A I put that together for the Court on Slide 22. My
3 range, between 36 and 45 percent for an \$80 million size,
4 the Merrill Lynch valuation based on my method one and
5 method two was between 32 and 35 percent, for \$15 million
6 size. Going from the bottom, we see that Lehman had a
7 valuation of 15 percent for the 80 million. Citi Group had
8 a valuation of 18 percent.

9 However, the Citigroup number was listed as
10 indicative levels only, and so I have ignored it, as did
11 Fund Party A. RBS, their quote for a \$15 million size was
12 43 percent. I had not used it, although I note it does say
13 it's good for today. QVT's valuation was 46 percent,
14 slightly above the top end of my computed range.

15 Q And how did the values that you developed convert to
16 dollars?

17 A You'll see that on Page 23. It's just a multiplication
18 of the price times 80 million. So for CMRA, that's between
19 29 and 36 million. Lehman is at 12 million, QVT is at 37
20 million.

21 Q Okay, Your Honor, that completes the CARB portion of
22 the direct.

23 THE COURT: Okay, Mr. Tambe?

24 MR. TAMBE: Can I ask just one clarification
25 question, just to smooth things out. The Lehman number the

1 witness has is 12 million, just I don't have a source for
2 that.

3 MR. TRACEY: That's Mr. (indiscernible)'s books
4 and records.

5 MR. TAMBE: Okay, thank you.

6 THE COURT: All right, so it probably does make
7 sense to call it a day, for the day, so that Mr. Tambe
8 doesn't end up midstream, in his cross-examination, all
9 right?

10 MR. TRACEY: Good. Thank you, Your Honor.

11 THE COURT: Okay, all right. If you would just
12 tidy up a bit, so that the 4:00 folks can move up to the
13 front. And did we talk about a starting time for tomorrow?
14 You have to remind me.

15 MR. TRACEY: We talked about 9:30, but if you
16 don't want to see us until 10:00, we'll sleep in.

17 THE COURT: Well, no, you may -- if you want to
18 sleep in, I'll be here at 9:30. If you want to sleep in,
19 I'm willing to do 10:00.

20 MR. TRACEY: We'll make (indiscernible)

21 MR. TAMBE: I think we'll go off the record now,
22 if we're talking about --

23 MR. TRACEY: About sleeping plans.

24 THE COURT: Yeah, we can. Sleeping plans, we're
25 off the record.

1 (Whereupon these proceedings were concluded at
2 3:58 PM)
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

C E R T I F I C A T I O N

I, Sonya Ledanski Hyde, certified that the foregoing
transcript is a true and accurate record of the proceedings.

Sonya Ledanski
Hyde

Digitally signed by Sonya Ledanski Hyde
DN: cn=Sonya Ledanski Hyde, o=Veritext,
ou, email=digital@veritext.com, c=US
Date: 2017.03.24 12:05:35 -04'00'

Sonya Ledanski Hyde

Veritext Legal Solutions

330 Old Country Road

Suite 300

Mineola, NY 11501

Date: March 2, 2017